TRANSCRIPT OF RECORD.

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, [redacted] 1922

No. [redacted]301

J. S. CULLINAN, PLAINTIFF IN ERROR,

vs.

A. S. WALKER, AS COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF TEXAS.

IN ERROR TO THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF TEXAS.

(28,760)

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1921.

No. 805.

J. S. CULLINAN, PLAINTIFF IN ERROR,

vs.

A. S. WALKER, AS COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF TEXAS.

IN ERROR TO THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF TEXAS.

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Caption.

District Court of the United States for the Southern District of Texas, Holding Sessions at Houston.

At Law.

No. 320.

J. S. CULLINAN, Plaintiff,

vs.

WALKER, as Collector of Internal Revenue for the First District of Texas, Defendant.

it remembered: That in the above entitled and numbered lately pending in said Court, in which Final Judgment was ed at the Regular September Term of said Court, 1921, to- On the 11th day of February, A. D. 1922, the Honorable C. Hutcheson, Jr., Judge of the District Court of the United for the Southern District of Texas, presiding, the following dings were had and taken in said Court, to-wit:

Plaintiff's First Amended Original Petition.

Filed February 21, 1921.

District Court of the United States for the Southern District of Texas, Sitting at Houston, Texas.

At Law.

No. 320.

J. S. CULLINAN, Plaintiff,

vs.

WALKER, as Collector of Internal Revenue for the First District of Texas, Defendant.

comes J. S. Cullinan, Plaintiff in the above styled and num- cause, leave of the Court being first had and obtained, and his his first amended original petition in lieu of his original on filed herein on the — day of ——, 1920, and for cause of respectfully represents to the Court:

That Plaintiff is now, was at the time of the filing of this suit n the various dates hereinafter alleged, a resident of Houston, s County, in the Southern District of Texas.

2. That A. S. Walker, designated in this cause as Defendant, as Collector of Internal Revenue for the First District of Texas, was at the time of the filing of this suit and on the various dates hereinafter alleged, the duly appointed, qualified and acting United States Collector of Internal Revenue for the district including Harris County, Texas, and, as such, was invested with the power and authority to collect taxes upon the income of persons living within said District that were levied and assessed under and by virtue of the Act of Congress of September 8, 1916, on income of citizens of United States and known as the "Income Tax Act."

3. That under and by virtue of the provisions of said Income Tax Act, and the regulations of the Secretary of the Treasury, in connection therewith, Plaintiff made out, signed, executed and returned to Defendant a statement and return of his income from all sources for the calendar year ending December 31, 1916,
3 which return was made out in accordance with forms prescribed by the Collector of Internal Revenue, and was returned within the time prescribed by said Income Tax Act.

4. That thereafter, at the request of Defendant, additional information as to business transactions and income of Plaintiff was furnished Defendant, and said additional information, together with said original return, is in the possession of Defendant, and the contents thereof are well known to him.

5. That under and by virtue of said original return, as made by Plaintiff, there appeared to be due and owing to the United States of America, as Income Tax for the year 1916, the sum of $3,914.90, which sum was paid by Plaintiff to the Defendant as said Collector of Internal Revenue.

6. That in addition to said sum, which Plaintiff acknowledges to be due to the United States of America as taxes for the year 1916 under the said Act, the Defendant, as such Collector, made claim against and collected from said Plaintiff additional taxes in the sum of $156,212.66, basing such claim on facts and circumstances growing out of the dissolution of a corporation known as Farmers Petroleum Company, as hereinafter alleged.

7. That in 1914 the Farmers Petroleum Company was organized under the laws of the State of Texas, with an original capital stock of $30,000.00, divided into 300 shares of the par value of $100.00 each. Later, in February, 1915, by charter amendment duly filed, the capital stock of the Company was increased from $30,000.00 to $100,000.00, with 1,000 shares of stock of the par value of $100.00 each, and the original stockholders purchased their pro rata of the newly issued stock. During 1915 the Company had an exceptionally prosperous business, and on January 1, 1916, had as capital an accumulated surplus employed in the business of producing, storing and selling crude petroleum of approximately $1,343,104.95.

8. That in the latter part of the year 1915 the officers and directors of the Farmers Petroluem Company, realizing that owing to the great increase in activities of said company a e amount of credit was necessary, which the Farmers Petroleum pany did not have, and that the organization of the company not sufficiently adapted or constructed to secure the line or unt of credit necessary for its business; and it also developed, ne officers and directors of said Farmers Petroleum Company advised by counsel, that, under the laws of the State of Texas, ngle corporation could not combine under one charter a pro- ng and pipe line business, which separate businesses it was neces- to conduct in developing the business initiated by said Farmers oleum Company.

That in order to procure the credit necessary for said business developed and in order that the developing and continuing of business and operation thereof might be in accordance with the of the State of Texas, as so advised by counsel, and for no other ons, the stockholders and directors of the Farmers Petroleum pany formulated a plan of reorganization of Farmers Petroleum pany, which plan contemplated the organization of three cor- ations: two corporations, one a producing company and one a line company, to be organized under the laws of the State of as, and one a holding company to be organized under the laws he State of Delaware. The surplus of the Farmers Petroleum pany was thereupon written up on its books on the basis of its pective possibility of its producing assets. The book entries n shows

00 shares of capital stock	$100,000.00
ned surplus	1,343,105.95
reorganization the book value of assets increased y	4,556,894.05
Asset valuation	$6,000,000.00

0. That on the 8th day of November, 1915, pursuant to said n of reorganization, a certificate of dissolution of the Farmers roleum Company was duly filed in the office of the Secretary of te of the State of Texas, the stockholders and relative interest aid Federal Petroleum Company at said time remaining as above set forth. As a result of which dissolution the directors of said Farmers Petroleum Company at said time, to-wit: 8th day of November, 1915, viz: said J. S. Cullinan, Jas. L. try, T. P. Lee, E. F. Woodward and W. C. Hogg, who were also ers of substantially all of the stock of said corporation, became operation of law "the Trustees in Liquidation of the Farmers roleum Company". No formal closing of the books of the rmers Petroleum Company was had at the time of the filing of l certificate of dissolution but its affairs and business and account- was continued by said Trustees until the 8th day of March, 1916.

11. That in pursuance to said plan of reorganization the said Trustees, being the owners of substantially all of the stock of said Farmers Petroleum Company, divided all of the assets of said company into two parts and, on the 8th day of March, 1916, organized under the laws of the State of Texas to corporations: (1) Republic Production Company, a producing company, and (2) American Petroleum Company, a pipe line company, to take over all the assets and business of the said Farmers Petroleum Company. Each of said companies, so organized, issued upon its organization $1,500,000.00 in capital stock, divided into fifteen thousand shares, each share of the par value of $100.00, and each also issued at said time $1,500,000.00 in *in* ten and fifteen year gold debenture bonds, each bond of the denomination of $1,000.00. Said bonds being a lien on the respective assets of said corporation. That contemporaneous with the organization of said Republic Production Company and American Petroleum Company, the said Trustees transferred to said Republic Production Company all of the properties of a producing nature that had been owned by the Farmers Petroleum Company which constituted the entire capital and the only assets of said Republic Production Company, and at the same time transferred to the American Petroleum Company all of the pipe line properties and a certain quantity of crude oil that had been owned by the Farmers Petroleum Company, which constituted the entire capital and the only assets of the said American Petroleum Company; and in turn, all of the stock and bonds of said Republic Production Company and American Petroleum Company, upon their issuance, were delivered to said Trustees pending the consummation of said plan of reorganization.

6 12. That pursuant to said plan of reorganization, a third company, American Republics Corporation, was incorporated, under the laws of Delaware, by said Trustees, to exist in the capacity solely of a holding company of the stock of said Republic Production Company and American Petroleum Company, and which said holding company received from said Trustees all of the stock, aggregating $3,000,000.00 par value of said Republic Production Company and American Petroleum Company, such stock constituting its entire capital and only assets. Said holding company thereupon issued and delivered its stock to the amount of $3,000,000.00 par value, consisting of thirty thousand fully paid shares, each of the par value of $100.00, to said Trustees, which stock of said holding company and the said bonds of the two new Texas corporations were then, in consummation of said plan of reorganization, distributed by said Trustees among the stockholders of the Farmers Petroleum Company in proportion to their respective stock ownership in said Farmers Petroleum Company. The stock of said holding company and the bonds so distributed represented the same identical properties formerly held in the name of the Farmers Petroleum Company and the total stock and bonds received by each respective stockholder was of the same value as the total stock formerly owned by him in the Farmers Petroleum Company.

12-A. Plaintiff avers that at no time was there any intent on the art of him or his associates to transfer said property out of their ands, or to sell or convey the same, but the sole purpose intended nd sole result accomplished by the various transactions above al-ged was to conduct said business in a lawful and convenient manner nd without affecting the relative rights and obligations of the stock-olders or the corporation.

13. That at and during the period of reorganization, and for a ong time prior thereto, the plaintiff owned in his own right 266.4 hares of the capital stock of the Farmers Petroleum Company, the ame representing 26.64 per cent interest in the entire capital stock f said Farmers Petroleum Company, and that Plaintiff received the same percentage of interest in bonds of the said Republic Production Company and American Petroleum Company and stock of said American Republics Corporation.

14. That Defendant, although fully informed as to the facts above tated, nevertheless wrongfully and without authority of said Income Tax Act, or of any other law, demanded of Plaintiff tax upon the mount of $1,571,760.00, as income subject to the tax provided in aid Income Tax Act, and thereafter the additional tax on said mount was paid by Plaintiff under protest as hereinafter more pecifically shown.

15. That in the original return of income made by Plaintiff for he year 1916 there was not included therein a list of stocks and onds received by Plaintiff from the transactions set forth above. or the reason that said stocks and bonds represented the same assets ormerly held in the name of and transferred by said Farmers Pe-roleum Company, as above set forth, and for the further reason that vhile the Plaintiff then had thirty shares of stock and three bonds vhere he had before had one share of stock, the shares of stock and onds in the new corporations represented exactly the same value vhich the shares of stock owned by Plaintiff had represented in the ld Company, and said Plaintiff was not any richer than he had een before, and such exchange as above set forth did not constitute ny increase in the net income of Plaintiff, but, notwithstanding hat said Defendant had been duly informed as to the said facts, nd said Defendant conceiving said exchange of stock and bonds f the new corporation for the stock of the old corporation to be a distribution of property and not an exchange of certificates of equal alue, on or about the 28th day of December, 1918, made an assess-ment of additional taxes of $156,212.66 against Plaintiff, under the provisions of the Act of Congress approved September 8, 1916, based upon the par value of said stock and bonds so received by Plaintiff of $1,571,760.00, or $100.00 per share of stock, and $1,000.00 per bond, all of which additional tax was paid by Plaintiff under protest as is more specifically hereinafter set forth.

16. That although said facts and allegations hereinabove set forth as to income of the Plaintiff were set out to Defendant, and said

facts were made known to him, and although Plaintiffs ap-
8 plied to Defendant to abate, remit and cancel said assessment, insofar as it exceeded the sum of $3,914.90, the amount admitted by Plaintiff to be lawfully due, yet, said Defendant wholly refused to consider the same and insisted upon payment of the additional tax, as indicated in the preceding paragraphs hereof; that accordingly, the Plaintiff, on the 13th day of January, 1919, and within ten days after notice from Defendant that he would not abate, remit and cancel said assessment, and that penalties and interest would accrue if such be not paid as and when demanded, paid Defendant, as Collector of Internal Revenue at Austin, Texas, the sum of $156,212.66, in payment of said additional assessment, taking the said Collector's receipt therefor, of which copy is thereto attached, marked Plaintiff's "Exhibit A," and prayed to be read as a part hereof. That said payment was made by Plaintiff under protest, (and to prevent distraint), addressed to said Defendant, copy hereof being hereto attached marked Plaintiff's "Exhibit B," and prayed to be read as a part hereof.

17. That all of said tax paid by this Plaintiff, all the transactions in respect of said properties alleged herein, and all claims for taxes under said Income Tax Act occurred at Houston, Texas, within the territory and jurisdiction of the District Court of the United States for the Southern District of Texas. That at the times of such transactions Defendant was the duly qualified and acting Collector of Internal Revenue for the Third District of Texas; but the district for which he is now the duly qualified and acting Collector of Internal Revenue is known as the First District of Texas, which embraces the territory hereinbefore alleged and referred to.

18. That thereafter, on or about October 25, 1919, Plaintiff filed with the Commissioner of Internal Revenue a claim for refund to him of said sum paid by Plaintiff, as aforesaid, copy of said claim being hereto attached, marked Plaintiff's "Exhibit C," and prayed to be read as a part hereof. That said Commissioner of Internal Revenue, although often and duly requested since October 25, 1919, to the time of filing this suit, to make return of said money
9 thus wrongfully and unlawfully collected and obtained from this Plaintiff by said Defendant, has wholly failed and refused to do so, and more than six months have elapsed since said claim was duly filed and presented. That notwithstanding said failure and refusal of said refund, there is justly due to plaintiff the sum of $156,212.66, so paid by him to Defendant as aforesaid under protest.

19. Plaintiff avers that the imposition on him of such additional tax, as aforesaid, was not warranted or authorized by said Revenue Act of 1916, and therefore was imposed in violation of the Sixteenth Amendment to the Constitution of the United States.

20. Plaintiff avers that such stock and bonds so received by him did not constitute income to him within the terms and meaning of the Sixteenth Amendment to the Constitution of the United States,

in so far as said Revenue Act of 1916 may purport to authorize imposition of income tax on plaintiff on account of receipt by of such stock and bonds, it conflicts with and violates the terms, aning and intent of said Sixteenth Amendment.

21. Plaintiff avers that such stock and bonds so distributed to him not constitute income within the terms, meaning and intent the Sixteenth Amendment to the Constitution of the United tes, and therefore the imposition of said tax on him on account said stock and bonds was in violation of said Amendment.

22. Plaintiff avers that the assessment of said additional tax inst him, and the collection thereof, was in violation of Article e, Section Two, Cl. 3, and Article One, Section Nine, Cl. 4, of e Constitution of the United States, requiring direct taxes to be portioned according to population.

Wherefore, the Plaintiff prays that upon hearing hereof, judgent be allowed Plaintiff against Defendant in the sum of $156,-2.66 with interest at the lawful rate of six per cent per annum ereon from January 13, 1919, as prayed for, together with his sts in this behalf incurred, together with all such other and further relief, general and special, as Plaintiff may be entitled to receive in the premises.

JOHN WALSH,
W. W. MOORE,
BEEMAN STRONG,
J. Y. POWELL,
Attorneys for Plaintiff.

NITED STATES OF AMERICA,
Southern District of Texas,
County of Harris:

Before me, the undersigned authority, on this day personally appeared J. Y. Powell, who, being first duly sworn, on oath states that e is attorney of record for Plaintiff in the foregoing Petition; that e has read such Petition, and that the matters therein stated are rue and correct.

J. Y. POWELL.

Subscribed and sworn to before me, this 21st day of February, 921.

[SEAL.]

C. S. HARRINGTON,
Notary Public in and for Harris County, Texas.

(EXHIBIT "A.")

Demand for Payment of Income and Excess Profits Tax for 1917.

Office Collector of Internal Revenue.

Austin, Texas, Dec. 28, 1918.

Demand hereby made for the amount of income and excess profits tax stated opposite your name. Failure to pay this tax on or before the due date given below will cause a 5 per cent penalty to accrue with interest at 1 per cent per month from the due date until paid.

Form 1040.

A. S. WALKER,
Collector of Internal Revenue.

Collr. Int. Rev.
Jan. 2, 1919.
Aug. P 3 L 10. 1916. R. A. R. 2-19-18.
Cullinan, J. S., Houston, Texas. $156,212.66.
Date due Jan. 7, 1919.
Paid under Protest.
(Paid Jan. 13, 1919. A. S. Walker.)
This part of the form must be sent to the Collector with Remittance.
Disregard previous notices.

11 (EXHIBIT "B.")

Dec. 30, 1918.

Hon. A. S. Walker,
Internal Revenue Collector,
Austin, Texas.

DEAR SIR:

As Attorney for Mr. J. S. Cullinan, I herewith enclose New York exchange on the Banker's Trust Company of New York, payable to your order, in the sum of One Hundred and Fifty-six Thousand, Two Hundred and Twelve Dollars and Sixty-six Cents ($156,212.66) in payment of additional assessment of income tax, for the year 1916, under the act of Congress approved Oct. 3, 1913, as amended by the act of Congress approved Sept. 8, 1916. We desire it understood that the payment of this tax is made under protest; that said tax was illegally and wrongfully assessed and collected for reasons in particular, without excluding or waiving others, as follows:

1st. The character of the assets assessed as income was and is capital and not income within the meaning of the act of Congress above referred to.

2nd. That the securities received for the properties of the Farmers Petroleum Company do not constitute taxable income.

3rd. That the capital assets of the Farmers Petroleum Company were not reduced to cash or its equivalent, and that the securities received in exchange for its properties are "capital assets" and constitute the "corpus" of the corporate estate.

4th. That the Farmers Petroleum Company was dissolved and its charter surrendered on November 8, 1915, thereby causing the title to the properties of the company to become vested in the stockholders, which properties then had reached the full value on which the tax herewith paid has been computed and, if said property is taxable as income, which is not admitted but denied, the 1915 rate should apply.

In issuing receipts for the payment of this tax, kindly let the receipts show that the payment was made under this protest.

Yours very truly,

(Signed) W. W. MOORE.

W. W. M./1.
Encl.

12 (EXHIBIT "C.")

Date of filing to be plainly stamped here.

Claim for Refund.

Taxes Erroneously or Illegally Collected.

Also Amounts Paid for Stamps Used in Error or Excess.

Important.

This claim should be forwarded to the Collector of Internal Revenue to whom the Tax was paid and must be accompanied by Collector's Receipt therefor.

STATE OF TEXAS,
County of Harris, ss:

J. S. Cullinan, Houston, Texas:

This deponent being duly sworn according to law deposes and says that this claim is made on behalf of the claimant named above, and that the facts stated below with reference to the claim are true and complete:

1. Business engaged in by claimant: Mining.

2. Character of assessment or tax: Income tax.

3. Amount of assessment or stamps: $160,581.33.

4. Amount now asked to be refunded (or such greater amount as is legally refundable): -157,095.94.

5. Date of payment of assessment or purchase of stamps: January 13, 1919.

Deponent verily believes that the amount stated in Item 4 should be refunded and claimant now asks and demands refund of said amount for the following reasons:

Said amount asked to be refunded was an increased tax which deponent was required to pay on what the department contends was a taxable dividend received from the Farmers Petroleum Company of Houston, Texas, as for 1916.

In March, 1916, the Farmers Petroleum Company was merged into the Republic Production and American Petroleum Companies, with the same assets, and with the same stockholders, having the same relative interest as in the Farmer's Petroleum Company.

The paid-in capital of the Farmer's Petroleum Co., consisted of 1,000 shares of stock	100,000.00
Earned surplus as at date of merger	1,343,105.95
	1,443,105.95
In reorganization the book value of the assets was increased by	4,556,894.05
Thus raising the asset valuation to	6,000,000.00
The department contends that inasmuch as the Farmers Petroleum Co., ceased to exist, the foregoing, less original stock	100,000.00
is taxable income	5,900,000.00

Deponent owned in the Farmers Petroleum Co., and still owned in the reorganized companies at the time of this assessment and payment, 26.64% of the capitalization, and this percentage of what the department holds to be dividend profit amounted to $1,571,760, and deponent was assessed an increased tax by reason of the inclusion by the department of said $1,571,760 in return of income for deponent or an amendment of such return and the assessment and collection of tax accordingly.

Deponent contends that a book valuation of property does not constitute the difference between cost and such book value a taxable profit under the income tax law. Deponent further contends that an increase in the number of shares against the same assets does not constitute a taxable profit but that such was what the department used as the basis of its assessment of increased tax against this deponent.

13 (EXHIBIT "C".)

There is given herewith a computation which, except for the elimination of the aforesaid item of $1,571,760 and the inclusion of an item of profit of $1,080 from the sale of bonds originally reported by deponent but excluded by the department, follows the revenue agent's report and recommendation in this case.

For further explanation and elucidation of deponent's reasons for refund reference is hereby made to brief of counsel in his behalf.

Statement.

1% A	47,009.54	
B	38,380.53	
		85,390.07
Profit on sale of bonds		1,080.00
		86,470.07
Dividends		59,851.24
Gross Income		146,321.31
Deductions per agent's report		35,196.40
Net Income		*111,124.91
Dividends	59,851.24	
Exemption	4,000.00	
		63,851.24
Income subject to normal tax		47,273.67
Normal tax @ 2%	945.47	
Credit by collection at source 1% A	470.10	
Balance of normal tax due	475.37	
*Additional tax:		
20,000 @		
20,000 @ 1%	200.00	
20,000 @ 2%	400.00	
20,000 @ 3%	600.00	
20,000 @ 4%	800.00	
11,124.91 @ 5%	556.25	
	2,556.25	
Total tax due	3,031.62	
Tax paid on original return.	3,914.90	
Tax paid under protest, assessment a/c Farmers Petroleum dividend.	156,212.66	
	160,127.56	
Refund due taxpayer	157,095.94	

And this deponent further alleges that the said claimant is not indebted to the United States in any amount whatever, and that no claim has heretofore been presented, except as stated herein, for the refunding of the whole or any part of the amount stated in Item 3.

(Signed) J. S. CULLINAN.

Sworn to and subscribed before me this 20th day of September, 1919.

[SEAL.] JAMES P. SMITH,
Notary Public, Harris Co., Texas.

Attached to the foregoing claim was a receipt for the taxes paid, copy of which is attached to the petition herein as Exhibit "A."

Indorsements: No. 320 D. L. at Law. In the United States District Court for the Southern District of Texas, at Houston. J. S. Cullinan, vs. A. S. Walker, as Collector of Internal Revenue. Plaintiff's first amended original petition. Filed Feby. 21, 1921. L. C. Masterson, Clerk.

14 *Defendant's Original Answer.*

Filed Sept. 23, 1920.

In the District Court of the United States for the Southern District of Texas, Sitting at Houston, Texas.

At Law.

No. 320.

J. S. CULLINAN, Plaintiff,

vs.

A. S. WALKER, as Collector of Internal Revenue for the First District of Texas, Defendant.

Now comes D. E. Simmons, United States Attorney for the Southern District of Texas, as attorney for A. S. Walker, Collector of Internal Revenue for the First District of Texas, defendant in the above styled and numbered cause, and for answer herein, says:

I.

Defendant demurs generally to said petition, and says that the same is wholly insufficient in law, and states no cause of action against defendant, and of this he prays the judgment of the Court.

II.

And further answering herein, defendant denies all and singular each and every allegation in said petition contained, and demanding strict proof of the same, he puts himself upon the country.

III.

And further answering herein, if such be necessary, defendant denies that any income tax was collected from plaintiff except what was due and payable to the United States of America under the law.

D. E. SIMMONS,
United States Attorney for the Southern District of Texas, representing the United States of America and A. S. Walker, as Collector of Internal Revenue for the First District of Texas,
By D. A. SIMMONS,
Assistant U. S. Attorney.

Indorsements: D. L. 320. In the United States District Court for the Southern District of Texas, at Houston. J. S. Cullinan, Plaintiff, vs. A. S. Walker, as Collector of Internal Revenue for the First District of Texas, Defendant. Defendant's original answer. Filed 23 day of Sept. 1920. L. C. Masterson, Clerk, By J. L. Sexton, Deputy.

15 *Final Judgment.*

Filed February 14th, 1922.

In the District Court of the United States for the Southern District of Texas, Sitting at Houston, Texas.

At Law.

No. 320.

J. S. CULLINAN, Plaintiff,

vs.

A. S. WALKER, as Collector of Internal Revenue for the First District of Texas, Defendant.

The above cause being at issue upon the First Amended Original Petition of the Plaintiff and the Answer of the Defendant, and being called in its regular order, at a regular term of the Court on this 11th day of February, 1922, came the parties by their respective attorneys and announced ready for trial, and both parties having waived a jury by waiver in writing filed herein, submitted the matters in controversy as well of fact as of law to the Court, and the parties by their respective attorneys tendered to the Court and asked leave to file herein an agreed statement of facts, dated February 19, 1921, and signed by the attorneys for the Plaintiff and Defendant, respectively, which stipulation was ordered to be filed and made a part of the record in this cause, and also tendered

to the Court and asked leave to file herein a supplemental agreed statement of facts dated February 22, 1921, signed by the attorneys for the Plaintiff and Defendant, respectively, which stipulation of supplemental statement of facts was ordered to be filed and made a part of the record in this cause, and thereupon neither party desiring to introduce additional evidence, and neither party requiring a jury, by consent of the parties this cause was submitted to the Court, in lieu of a jury, upon said stipulation of facts and said supplemental stipulation of facts, and upon argument and briefs of counsel, and after due deliberation, having duly made its decision in writing in favor of the Defendant and against Plaintiff with findings of fact and conclusions of law duly filed in the Clerk's office of said Court;

16 Now, on said decision and on motion of D. E. Simmons, United States District Attorney and Attorney for Defendant, it is ordered, adjudged and decreed that Plaintiff, J. S. Cullinan, take nothing by this suit, and that the said Defendant, A. S. Walker, as Collector of Internal Revenue, go hence without day, and that said Defendant do recover against the said Plaintiff his cost and charges by him about his defense in this behalf expended, to be taxed, for which execution may issue; to which judgment, the Plaintiff then and there in open court excepted, and gave notice that within the time allowed by law, he would apply for writ of error to the Supreme Court of the United States.

Dated February 11th, 1922.

J. C. HUTCHESON, JR.,
United States District Judge.

Indorsements: No. 320 D. L. J. S. Cullinan, Plaintiff, vs. A. S. Walker, as Collector of Internal Revenue for the First District of Texas, Defendant. Final judgment. Filed 14th day of February, A. D. 1922. L. C. Masterson, Clerk, By M. Anderson, Deputy.

Bill of Exceptions.

Filed February 16th, 1922.

he District Court of the United States for the Southern District of Texas, Sitting at Houston, Texas.

At Law.

No. 320.

J. S. CULLINAN, Plaintiff,

vs.

S. WALKER, as Collector of Internal Revenue for the First District of Texas, Defendant.

Bill of Exceptions.

e it remembered, that this action being at issue and on the ndar was brought to trial at a stated term of said Court on the n day of February, 1922, before the Honorable J. C. Hutcheson, rict Judge, presiding. Upon the said cause being called for l, Messrs. John Walsh, W. W. Moore, Beeman Strong and J. Y. ell, appeared as Counsel for the plaintiff, and Honorable D. E. mons, United States District Attorney for the Southern District Texas, and Carl D. Matz, Special Attorney of the Bureau of rnal Revenue, appeared as Counsel for the defendants.

hereupon, a trial by jury was waived by waiver in writing and herein, and thereupon the following proceedings were had, the following evidence introduced, and none other.

he parties then introduced in evidence a stipulation of facts as ows:

In the District Court of the United States of America for the Southern District of Texas, Houston Division.

D. L.

J. S. CULLINAN, Plaintiff,

vs.

S. WALKER, as Collector of Internal Revenue for the First District of Texas, Defendant.

he parties in this cause, by their attorneys of record, hereby ve a jury, and agree that the cause may be tried before the Court he following agreed statement of facts, evidence of which, ex- this agreement, need not further be made upon the trial.

The material facts in this cause are hereby agreed to be as follows:

1. Plaintiff, J. S. Cullinan, is now and was at the time of the filing of this suit, and on the various dates and times hereinafter specified, a resident of Houston, Harris County, in the Southern District of Texas.

2. A. S. Walker, designated in this cause as defendant, was at the time of the filing of this suit, and on the various dates and times herein specified, the duly appointed, qualified and acting United States Collector of Internal Revenue, for the District including Harris County, Texas.

3. That Plaintiff, in compliance with the provisions of the Act of Congress of September 8th, 1918, and the Regulations of the United States Treasury Department thereunder, made a return of his annual net income for the twelve months ending December 31st, 1916, as required by said Act and said regulations, and by which return there appeared to be due from the Plaintiff, as income tax for the year 1916 the sum of Three Thousand Nine Hundred, and Fourteen and 90/100 ($3,914.90) Dollars, which sum was duly paid by the Plaintiff to the proper authorities.

4. That thereafter the defendant, as such Collector of In-
19 ternal Revenue, acting under and pursuant to his instructions from the Commissioner of Internal Revenue at Washington, D. C., on the 28th day of December, 1918, mailed notice and demand for an additional income tax claimed by said Collector to be due from the Plaintiff for the said year 1916 in the sum of One Hundred Fifty-six Thousand, Two Hundred and Twelve and 66/100 ($156,212.66) Dollars, basing such additional tax on certain transactions in which the plaintiff was involved and which are as follows:

a. Farmers Petroleum Company was incorporated under the laws of the State of Texas on May 1st, 1914, with capital stock of Thirty Thousand Dollars ($30,000.00) divided into three hundred fully paid shares of the par value of One Hundred ($100.00) Dollars each fully subscribed and paid for at par in cash at the time, and said company was engaged during the entire period of its existence in the production of petroleum in the State of Texas.

b. By charter amendment duly filed on the 15th day of February, 1915, the capital stock of said Farmers Petroleum Company was increased to One Hundred Thousand Dollars ($100,000.00), consisting of One Thousand (1,000) fully paid shares each of the par value of One Hundred Dollars ($100.00), and the original stockholders subscribed and paid in cash at par on said date for their respective pro rata portions of such increase in the capital stock, all stock of said company being then owned and held as follows:

Stockholders.	Shares.	Percentage.
S. Cullinan	266.40	$26.64
. Autry	133.20	13.32
C. Hogg	133.20	13.32
W. Ward	6.66	0.666
of W. B. Sharp	59.94	5.994
P. Lee	167.00	16.70
F. Woodward	167.00	16.70
H. Todd	13.32	1.332
n Slater	13.32	1.332
. Sweeney	13.32	1.332
A. Ryan	13.32	1.332
L. Considine	13.32	1.332
	1,000.00	100.00

c. That in the latter part of the year 1915 the officers and directors of the Farmers Petroleum Company, realizing that owing he great increase in activities of said company, a large amount redit was necessary, which credit the Farmers' Petroleum Com- y did not have, and that the organization of the company was not iciently adapted or constructed to secure the line or amount of lit necessary for its business; and it also developed, as the officers directors of said Farmers' Petroleum were advised by counsel, under the laws of the State of Texas, a single corporation could combine under one charter a producing and pipe line business, ch separated businesses it was necessary to conduct in developing business initiated by said Farmers' Petroleum Company.

. That in order to procure the credit necessary for said business, t developed and in order that the developing and continuing of said business and operation thereof, might be in accordance with laws of the State of Texas, as so advised by counsel, and for no er reason, the stockholders and directors of the Farmers' Petro- n Company formulated a plan of reorganization of Farmers' roleum Company, which plan contemplated the organization of e corporations; two corporations, one a producing company and a pipe line company, to be organized under the laws of the State Texas, and one a holding company to be organized under the s of the State of Delaware.

The balance sheet of the Farmers' Petroleum Company, as of ruary 29, 1916, is as follows:

Assets.

n	$78,977.04
ounts Receivable	9,678.82
ms	30.86
xpired Insurance	14,318.37

General and Office:		
Automobile	$2,244.10	
Engineering & Equipment	391.71	
Furniture & Fixtures	1,866.16	
		4,501.97
Producing department:		
Leases	20,679.17	
Land in fee	2,623.75	
Matagorda Well Equipment	87.50	
Plant and Equipment	284,774.57	
		$408,164.99
21		
Pipe line department:		
Lands in fee	$5,724.52	
Pipe Stocks	2,043.85	
Gathering Lines	6,282.08	
Trunk Lines, Tanks & Eqpmt	36,285.08	
E. Houston Lines, Tanks & Equipment	697,713.68	
		$799,849.43
Total Assets		$1,215,521.78

Capital and Liabilities.

Unpaid Wages	19.65
Bills Payable	117,380.01
Capital Stock	100,000.00
Surplus	998,122.12
Total	$1,215,521.78

f. In order to make the book figures of its assets coincide with the actual values which, in view of their prospective possibilities, they were believed to have, the book values of the assets of the Farmers' Petroleum Company were adjusted as of March 1, 1916, and the values assigned to said assets in connection with their apportionment between the American Petroleum Company and the Republic Production Company, were as follows:

Transferred to Republic Production Co.

Producing Department, Book Value as of February 29, 1916	$308,164.99
Appreciation as of March 1, 1916	2,691,835.01
	$3,000,000.00

Transferred to American Petroleum Co.

General and Office	$4,501.97
Pipe Line Department	799,849.43
Oil Inventories	1,546,850.28
10% appreciation General and Pipe Line	80,435.14
	2,431,636.82
Less accounts payable in the sum of	32,380.14
	2,399,256.81
Oil to be run	600,743.19
	$3,000,000.00

In the apportionment by the trustees of the properties between the Republic Production Company and the American Petroleum Company, in order to equalize such apportionment between both of said companies, it was provided that oil of the value of *of* $600,743.19 should be run free of charge from Republic Production Company to American Petroleum Company, which was done.

g. Although the oil in pipe lines and tanks was not carried on the books of the Farmers' Petroleum Company as shown in Paragraph *"e"* above, in the transfer to the American Petroleum Company as of March 1, 1916, an oil inventory of $1,546,850.28 as shown in Paragraph *"f"* above, was taken into consideration.

h. The result of the above adjustment was to place the book value of the assets of the Farmers' Petroleum Company at $6,000,000.00 represented by liabilities as follows:

One Thousand shares of Capital stock	$100,000.00
Earned surplus (not taking into consideration oil on hand of the value of $1,546,850.28)	1,343,105.95
Increase of the book value of assets	4,556,894.05
Total	$6,000,000.00

i. That on the 8th day of November, 1915, pursuant to said plan of reorganization, a certificate of dissolution of the Farmers' Petroleum Company was duly filed in the office of the Secretary of State of the State of Texas, the stockholders and relative interest in said Farmers' Petroleum Company at said time remaining as above set forth. As a result of which dissolution the directors of said Farmers' Petroleum Company at said time, to-wit: the 8th day of November, 1915, viz: Said J. S. Cullinan, Jas. L. Autry, T. P. Lee, E. F. Woodward, and W. C. Hogg, who were also owners of substantially all of the stock of said corporation, became by operation of law "the Trus-

tees in Liquidation of the Farmers Petroleum Company." No formal closing of the books of the Farmers Petroleum Company was had at the time of the filing of said certificate of dissolution, but its affairs and business and accounting was continued by said Trustees until the 8th day of March, 1916.

j. That in pursuance to said plan of reorganization, said Trustees divided all of the assets of said Farmers Petroleum Company, into two parts, and on the 8th day of March, 1916, organized two corporations under the laws of the State of Texas: one—Republic Production Company, a producing company, and two—American Petroleum Company, a pipe line company, to take over all the assets and business of said Farmers Petroleum Company. Each of said companies so organized issued upon its organization $1,500,000.00 in capital stock, divided into 15,000 shares, each share of the
23 par value of $100.00 and each also issued at said time $1,500,000.00 in gold debenture bonds, the Republic Production Company bonds payable in ten years and the American Petroleum Company bonds payable in fifteen years, each bond of the denomination of $1,000.00, said bonds being a lien on the respective assets of said corporations. Contemporaneous with the organization of said two new corporations, and in pursuance of said plan of reorganization, said trustees transferred to said Republic Production Company, all the properties of a producing nature that had been owned by the Farmers Petroleum Company, which said properties constituted the entire capital and only assets of said Republic Production Company, and at the same time transferred to American Petroleum Company all the pipe line properties and a certain quantity of crude oil that had been owned by the Farmers Petroleum Company, which constituted the entire capital and only assets of said American Petroleum Company; and in turn, all of the stocks and bonds of said Republic Production Company and American Petroleum Company, upon their issuance, were delivered to said Trustees pending the consummation of said reorganization.

k. That pursuant to said plan of reorganization, a third company, American Republics Corporation, was incorporated under the laws of Delaware, by said Trustees, to exist in the capacity solely of a holding company of the stock of said Republic Production Company and American Petroleum Company, and which said holding company received from said Trustees all of the stock, aggregating Three Million Dollars ($3,000,000.00) par value of said Republic Production Company and American Petroleum Company, such stock constituting its entire capital and only assets. Said holding company thereupon issued and delivered its stock to the amount of Three Million Dollars ($3,000,000.00) par value, consisting of Thirty thousand (30,000) fully paid shares, each of the par value of One Hundred Dollars ($100.00) to said Trustees which stock of said holding company and the said bonds of the two new Texas corporations were then, in consummation of said plan of reorganization, distributed by said Trustees among the stockholders of the Farmers

Petroleum Company in proportion to their respective stock
24 ownership in said Farmers Petroleum Company, all of said stockholders of American Republics Corporation being identical with those of Farmers Petroleum Company upon its dissolution.

The American Petroleum Company and the Republic Production Company had, at the time of the distribution of the stock, of the American Republics Corporation and the bonds of the American Petroleum Company and the Republic Production Company, no assets other than those transferred to each of them respectively by the Trustees in liquidation of the Farmers Petroleum Company, and the assets so transferred were of the same value when the stock of the American Republics Corporation, and the aforementioned bonds were issued and distributed as aforesaid, as they (i. e., said assets) were when held by the said Trustees of the Farmers Petroleum Company.

5. That at and during the period of reorganization, and for a long time prior thereto, the Plaintiff owned in his own right 266.4 shares of the capital stock of the Farmers Petroleum Company, the same representing 26.64 per cent interest in the entire capital stock of said Farmers Petroleum Company, and that Plaintiff received the same percentage of interest in bonds of the said Republic Production Company and American Petroleum Company and stock of said American Republics Corporation.

6. That after said notification and demand for the payment of said additional tax, the Plaintiff filed with said Collector of Internal Revenue an application for the abatement, remission and cancellation of said assessment, which application was denied and the plaintiff did on the 13th day of January, 1919, pay under protest to said Defendant, A. S. Walker, Collector, said additional income tax so assessed for the period ending December 31st, 1916, in the sum of One Hundred Fifty-six Thousand, Two Hundred and Twelve and 66/100 ($156,212.66) Dollars, and at the same time filed with the Defendant, A. S. Walker, a written protest against the payment of the same.

7. That subsequently the Plaintiff filed with the Defendant A. S. Walker, Collector, for presentation to the Commissioner of
25 Internal Revenue, a claim for the refund of the net amount of the assessment of said additional income tax, to-wit: One Hundred Fifty-six Thousand, Two Hundred and Twelve and 66/100 ($156,212.66) Dollars.

8. At the time of the filing of this suit, more than six months from the date of filing and presenting said claim for refund to the Commissioner of Internal Revenue had elapsed, and no action had been taken thereon by said Commissioner, but thereafter, to-wit: on the 24th day of August, A. D. 1920, said claim was rejected by said Commissioner.

9. Exhibits "A," "B" and "C," attached to Plaintiff's petition in this cause, are true and correct copies of the notice and demand,

written protest, the receipt for said taxes paid, and claim for refund hereinbefore mentioned, and the contents thereof are made a part of this agreed statement.

10. Plaintiff is not now, nor was he during the times mentioned herein, a member of any stock exchange or of any similar organization or association engaged in the business of trading in, buying or selling stocks, bonds, or other securities. Nor was he in any way engaged in the business of buying or selling stocks and bonds or other securities.

11. That the transfer of said properties and the exchange of said stocks and bonds, the payment of said additional income tax, the protest thereof, and the filing of said claim for refund, occurred within the territory and jurisdiction of the District Court of the United States for the Southern District of Texas.

12. The Government in assessing and collecting the taxes, refund of which is sought in this suit, valued the stock and bonds distributed to the plaintiff, at par. The plaintiff in this suit is not seeking to recover any part of the amount so sued for on account of excessive valuation of such stock and bonds.

13. This agreement may be introduced in evidence by either party, without objection.

26 Executed in duplicate, this the 19th day of February, A. D. 1921.

J. S. CULLINAN,
Plaintiff,

(Sgd.) By JOHN WALSH,
(Sgd.) BEEMAN STRONG,
Attorneys of Record.

A. S. WALKER,
As Collector of Internal Revenue,

(Sgd.) By D. E. SIMMONS,
United States Attorney.

CARL D. MATZ,
Special Attorney, Bureau of Internal Revenue.

Thereupon the parties introduced in evidence and filed a further and supplemental stipulation of facts in writing as follows:

In the District Court of the United States for the Southern District of Texas, Sitting at Houston, Texas.

At Law.

No. 320.

J. S. CULLINAN, Plaintiff,

vs.

. S. WALKER, as Collector of Internal Revenue for the First District of Texas, Defendant.

It is hereby stipulated by and between the parties to the above ıtitled cause, by their respective attorneys, that supplementing the ıtatement of Facts stipulated to in this cause, and filed herein, that ıe following facts be agreed to and be considered as evidence in ıis cause;

1. That the hereto annexed, marked "Exhibit A," is a true copy affidavit accompanying the charter of Republic Production Comany upon incorporation thereof, and which affidavit was filed in ıe office of Secretary of State of the State of Texas, with said charter the time of the incorporation of said Republic Production ompany.

2. That one share of stock was given to each of the following ersons, who subscribed said affidavit, and who were subscribers to ıe capital stock of said Company: T. P. Lee, E. F. Woodward, . C. Hogg, E. G. Floeter, C. H. Ash. That said share of stock was aid for out of the funds of the Farmers Petroleum Company, for ıe purpose of enabling said persons to qualify as stockholders and irectors in perfecting the incorporation of said Republic Production ompany, in accordance with the laws of the State of Texas, and in rder to carry out the said plan of reorganization of said Farmers etroleum Company and to give said persons qualifying shares for ıat purpose.

3. That a like affidavit accompanied the charter of American etroleum Company, upon its incorporation, except as to description of property—said affidavit, describing the property set 8 aside to American Petroleum Company in the division of Farmers Petroleum Company assets—and the same was likeise filed in the office of Secretary of State of the State of Texas with ıe charter of said American Petroleum Company.

4. That the hereto annexed, marked "Exhibit B", is a true copy f the consent of all stockholders of Farmers Petroleum Company o the dissolution of said Company as the same is filed with the ecretary of State of the State of Texas on the 8th day of ovember, 1915.

5. In this connection, it is understood and agreed that the stock appearing in the certificate of dissolution in the name of Fidelity Trust Company in truth and in fact was the property of and belonged to J. S. Cullinan, Jas. L. Autry, W. C. Hogg, B. W. Ward, Estate of W. B. Sharp, C. H. Todd, John Slater, J. P. Sweeney, E. A. Ryan, J. L. Considine; that their true ownership and their number of shares and percentage, as stated on page two of the original stipulations of facts filed in this cause on the 21st day of February, 1921, are correct:

6. That the hereto annexed, marked "Exhibit C," is a copy of the charter of Republic Production Company; that the hereto annexed, marked "Exhibit D", is a copy of original charter of the American Petroleum Company; that the hereto annexed, marked "Exhibit E" is a copy of the bond issue by the Republic Production Company; that the hereto annexed, marked "Exhibit F", is a copy of the bond issue by the American Petroleum Company.

7. It is agreed that plaintiff during the years 1915 and 1916, kept his books on basis of actual receipts and disbursements, and made his income tax returns accordingly; that he was advised by counsel that the dissolution of Farmers Petroleum Company and its reorganization into the American Petroleum Company, Republic Production Company and American Republics Corporation did not result in any taxable gains or profits to him; that if he had believed that under the law the dissolution of the Farmers Petroleum Company, in 1915 brought about a distribution of any part of its assets to him in a manner, making the same taxable to him for the
29 year 1915, he would have included the same in his 1915 return; and if he had believed that the organization of the Republic Production Company, American Petroleum Company and American Republics Corporation and the distribution of securities resulting therefrom, as shown in this record resulted in taxable gains or profits to him for 1916, that he would have included such in his 1916 returns.

Executed in duplicate, this the 22nd day of February, A. D. 1921.

(Signed) J. S. CULLINAN,
Plaintiff,
By JOHN WALSH,
BEEMAN STRONG,
W. W. MOORE,
J. Y. POWELL,
Attorneys of Record.
A. S. WALKER,
As Collector of Internal Revenue,
By D. E. SIMMONS,
United States Attorney.
CARL D. MATZ,
Special Attorney, Bureau of Internal Revenue.

30 "EXHIBIT A."

Affidavit to Subscription and Payment.

THE STATE OF TEXAS,
County of Harris:

Before the undersigned authority on this day personally appeared T. P. Lee, E. F. Woodward, W. C. Hogg, E. G. Floeter, and C. H. Ash, who being by me duly sworn, each for himself says:

That they are the identical persons whose names are subscribed to and who executed the accompanying Charter of Republic Production Company; that the residence and post office addresses of each and all the subscribers to Capital Stock of said Company is Houston, Harris County, Texas, and that said subscribers and the amounts subscribed by each and paid by each are the following:

Subscriber.	No. of shares.	Amount paid.
T. P. Lee	1	$100.00
E. F. Woodward	1	100.00
W. C. Hogg	1	100.00
E. G. Floeter	1	100.00
C. H. Ash	1	100.00
Trustees of Farmers Petroleum Company in Liquidation, to wit: T. P. Lee, E. F. Woodward, W. C. Hogg, J. S. Cullinan, and J. S. Autry	14,995	1,499,500.00
Totals		$1,500,000.00

31 That all said amounts have been so subscribed and paid in good faith by the execution and deposit in the possession of the members of the board of Directors of said Republic Production Company of a good and sufficient duly executed Deed of Conveyance to and in the name of said Company, to be deemed finally and effectually delivered simultaneously with the filing of said Charter of said Company in the office of the Secretary of State, such deed so conveying properties described therein of following charter:

(1) Mineral rights subject to royalty in about 258.20 acres of the Stephenson Survey in Harris County, Texas, in the so-called Humble Oil Field.

(2) Other fee simple, leasehold and mineral rights in other lands in said county and in other Counties in Texas fully shown and described in said deed of which copy is annexed.

(All the foregoing subject to the royalty and other rights defined in the respective muniments of title.)

(3) All of the field and warehouse equipment and supplies incident to the operation of producing oil upon said properties.

That the cash value of said properties so received by the Company is Three Million Dollars or more and that such properties have been so taken and received at that price from said parties as fully shown by copy of said deed attached hereto and made a part hereof and referred to for further detail as to description, location, etc. The total amount of said purchase price being Three Million Dollars, is represented by all the said Capital Stock of said Company to the amount of $1,500,000.00 face value and by the Ten Year Six Per Cent Sinking Fund Gold Debenture Bonds of the Company to the amount of $1,500,000.00 par value.

(Sgd.) T. P. LEE.
E. F. WOODWARD.
W. C. HOGG.
E. G. FLOETER.
C. H. ASH.

Sworn to and subscribed before me, this the 6th day of March, 1916.

[SEAL.] (Sgd.) E. E. CLARK,
Notary Public in and for Harris County, Texas.

32 "EXHIBIT B."

THE STATE OF TEXAS,
Harris County:

The undersigned, being all of the stockholders, and all members of the Board of Directors of, and all of the officers of Farmers Petroleum Company, a corporation created under the laws of Texas, having its home office in Houston, Texas, do hereby consent and agree that said corporation shall be and is hereby dissolved, said dissolution to take effect upon the filing of this certificate in the office of the Secretary of State of the State of Texas, and that the members of the Board of Directors at the time of dissolution, consisting of T. P. Lee, President, E. F. Woodward, Vice President, J. S. Cullinan, W. C. Hogg, and James L. Autry, be and they are hereby authorized and directed to do all things necessary and proper under the law in settling all the affairs of the corporation, including the payment of debts, the collection of all claims and accounts and other assets and the sale and disposition of all such assets and the distribution among stockholders of all the avails of such sales, and in the conduct of such affairs the approval of a majority of said five

named persons shall be adequate to bind the trust fund represented by all. The Post Office address and place of residence of each and every stockholder, officer and director is Houston, Texas.

T. P. LEE,
Stockholder, President and Director.
E. F. WOODWARD,
Stockholder, V. P. and Director.
WILL C. HOGG,
Stockholder, Treasurer and Director.
E. G. FLOETER,
Secretary.
JAS. L. AUTRY,
Stockholder & Director.
J. S. CULLINAN,
Stockholder and Director.
FIDELITY TRUST COMPANY OF HOUSTON,
Stockholder,
By J. S. CULLINAN,
Its President.

STATE OF NEW YORK,
County of New York, ss:

Before the undersigned, a Notary Public in and for said State and County, on this day personally appeared T. P. Lee, J. S. Cullinan and James L. Autry, known to me to be the persons whose names are subscribed to the foregoing instrument, and acknowledged to me that they executed the same for the purpose and considerations stated therein, and the said J. S. Cullinan so acknowledged in behalf of Fidelity Trust Company as the President thereof.

Given under my hand and seal of office November 4, 1915.

[SEAL.] MARY A. McCARTHY,
Notary Public.

#21 New York Co., New York Register #7045.
Com. expires March 30th, 1917.

33 STATE OF TEXAS,
County of Harris, ss:

Before the undersigned, a notary public in and for said State and County, on this day personally appeared W. C. Hogg, E. F. Woodward, and E. G. Floeter, known to me to be the persons whose names are subscribed to the foregoing instrument, and acknowledged to me that they executed the same for the purposes and consideration stated therein, and in the several capacities therein set forth.

Given under my hand and seal of office November 7th, 1915.

[SEAL.] E. E. CLARK,
Notary Public in and for Harris County, Texas.

The undersigned, being the President, the Secretary and the Treasurer of the Farmers Petroleum Company, named above, do hereby certify that the foregoing is a true and correct statement of the action of the stockholders of said company; that the names signed thereto constitute a list of all the stockholders of said Company; and of the directors and all the directors of the company and of all the officers thereof, and that the facts set forth and stated in said statement and in this certificate are true and correct.

Witness our hands and the corporate seal of said company this 4th day of November, 1915.

T. P. LEE,
President of Farmers Petroleum Company.
[SEAL.] E. G. FLOETER,
Secretary of Farmers Petroleum Company.
WILL C. HOGG,
Treasurer of Farmers Petroleum Company.

THE STATE OF TEXAS,
County of Harris:

Before me, the undersigned authority, on this day personally appeared T. P. Lee, E. G. Floeter, and Will C. Hogg, all of whom are known to me to be the persons whose names are subscribed to the foregoing instrument, and they severally acknowledged to me that they executed the same for the purposes and consideration therein expressed and in the several capacities therein set forth.

Given under my hand and seal of office this 7th day of November, A. D. 1915.

[SEAL.] E. E. CLARK,
Notary Public in and for Harris County, Texas.

34 "EXHIBIT C."

Charter of Republic Production Company.

Filed March 7th, 1916.

THE STATE OF TEXAS,
County of Harris:

Know all men by these presents: That we, the undersigned, all being resident citizens of said State and County, have formed and do hereby form ourselves, our associates and successors, into a corporation under and by virtue of the General Laws of the State of Texas, and for said corporation do hereby declare and adopt this instrument as the Charter thereof, with terms as follows:

1. The name of this corporation shall be "Republic Production Company".

The purpose for which it is formed is to establish and maintain company, with authority to contract for the lease and purchase right to prospect for, develop and use coal and other minerals petroleum; also the right to erect, build and own all necessary nks, cars and pipes necessary for the operation of the business Company.

The place where the business of said corporation is to be trans- and its Home Office, is Houston, in Harris County, Texas, it may operate elsewhere in the State of Texas and in other or jurisdictions at its will and discretion.

The term for which it is to exist shall be fifty years from the of the filing of this Charter in the office of the Secretary of

This corporation is to be managed by a Board of Directors to st of five members (subject to increase or decrease in number r the law), and the names and residences of those who are inted for the first year and until their successors are selected s follows:

Name.	Residence.
. Lee	Houston, Texas.
F. Woodward	Houston, Texas.
C. Hogg	Houston, Texas.
. Floeter	Houston, Texas.
. Ash	Houston, Texas.

The amount of the capital stock of this corporation is hereby at the sum of One Million Five Hundred Thousand Dollars. same to be divided into 15,000 shares, each of par value of .00, all of which is subscribed for and fully paid in at the time he filing of this Charter, so that all such shares shall be full and non-assessable.

itness our hands at Houston, Texas, this the 6th day of March, . 1918.

(Signed) T. P. LEE.
E. F. WOODWARD.
W. C. HOGG.
E. G. FLOETER.
C. H. ASH.

STATE OF TEXAS,
County of Harris:

fore me, the undersigned authority, on this day personally ap- ed T. P. Lee, E. F. Woodward, W. C. Hogg, E. F. Floeter, and . Ash, all of whom are known to me to be the persons whose es are subscribed to the foregoing instrument, and who severally owledged to me that they executed the same for the purposes consideration therein expressed.

Given under my hand and seal of office, this the 6th day of March, A. D. 1916.

[SEAL.] E. E. CLARK,
Notary Public in and for Harris County, Texas.

Filed in the Office of the Secretary of State this 7th day of March, 1916.

(Signed) JNO. G. McKAY,
Secretary of State.

36 "EXHIBIT D."

Charter of American Petroleum Company.

Filed March 7th, 1916.

THE STATE OF TEXAS,
County of Harris:

Know all men by the these presents:

That we, the subscribers, all being resident citizens of said State and County, do hereby form ourselves, our associates and successors into a corporation under and by virtue of the General Laws of the State of Texas, and do hereby declare and adopt this instrument as in the Charter of said Corporation, with terms as follows:

1. The name of this Corporation shall be "American Petroleum Company."

2. This Corporation is organized for the purpose of storing, transporting, buying and selling oil and as such corporation shall possess and may exercise all of the powers provided for in Chapter Twenty-four of Title 25 of the Revised Civil Statutes of the State of Texas of 1911 (R. S. Arts. 1303 to 1308), and also all of the powers set forth in chapter 41 of the General Laws of the State of Texas passed by the thirty-fourth Legislature of Texas, Regular Session (General Laws, 1914, page 82), the provisions of which Chapter are hereby expressly accepted in accordance with the terms thereof.

3. The place where the business of said Corporation is to be transacted, and its home office, is Houston, in Harris County, Texas, and it may operate elsewhere in the State of Texas, and in other States or jurisdictions at its discretion.

4. The term for which said Corporation shall exist is fifty years from the date of the filing of this Charter in the office of the Secretary of State.

5. This Corporation is to be managed by a board of directors to consist of five members (subject to increase or decrease in
37 number under the law), and the names and residences of those who are appointed for the first year and until their successors are selected are as follows:

Name.	Residence.
d C. Smith	Houston, Texas.
W. Moore	Houston, Texas.
W. Ward	Houston, Texas.
E. Clark	Houston, Texas.
H. Waldron	Houston, Texas.

. The Amount of the Capital Stock of this Corporation is hereby d at the sum of one million five hundred thousand dollars, the ie to be divided into 15,000 shares, each of par value of $100.00. of which shares have been fully subscribed and paid for at and ore the time of the filing hereof and are accordingly fully paid l non-assessable.

Witness our Hands, at Houston, Texas, this the 6th day of March, D. 1916.

(Signed) FRED C. SMITH.
W. W. MOORE.
B. W. WARD.
E. E. CLARK.
R. H. WALDRON.

E STATE OF TEXAS,
County of Harris:

Before me, the undersigned authority, on this day personally peared Fred C. Smith, W. W. Moore, B. W. Ward, E. E. Clark, l R. H. Waldron, known to me to be the persons whose names subscribed to the foregoing instrument, and they severally ac-owledged to me that they executed the same for the purposes and sideration therein expressed.

Given under my hand and Seal of office, this the 6th day of rch, A. D. 1916.

C. H. JOHNSTON,
Notary Public in and for Harris County, Texas.

Filed in the Office of the Secretary of State this 7th day of March, 6.

(Signed) JNO. G. McKAY,
Secretary of State.

38 "EXHIBIT E."

(*Form of Debenture Bond.*)

United States of America,

$1,000. The State of Texas. $1,000.

No. —.

Republic Production Company.

Ten Year Six Per Cent Sinking Fund Gold Debenture Bond.

Republic Production Company, a corporation of the State of Texas, home office Houston, (hereinafter called Company), for value received, hereby promises to pay to the bearer hereof the sum of one thousand dollars in gold coin of the United States of America, of or equal to the present standard of weight and fineness, on the first day of April, A. D. 1926, at the office of Fidelity Trust Company, in Houston, Texas, and to pay interest on said sum from date hereof until the same shall be paid, at the rate of six per cent per annum, payable in like gold coin, such interest until maturity to be payable semi-annually at said office on the first day of October and the first day of April in each year, in accordance with and only upon or after the surrender of the respective coupons for such semi-annual interest as they severally become due.

The Company agrees that it will pay both the principal of and interest upon this Bond without deduction for any taxes, assessments or governmental charges which the Company may be required or permitted to pay thereon or to retain therefrom under any present or future law; provided, the Company will pay, when payable, United States Income Tax, not exceeding one per cent on income derived from interest paid hereon.

This Bond is one of an issue of 1,500 coupon Bonds numbered consecurively from 1 to 1500, both inclusive, each of $1,000.00 denomination, all of like terms, date and tenor, aggregating not to exceed One Million Five Hundred Thousand Dollars at any one time outstanding, all issued and to be issued under and equally secured by a Trust Agreement, dated the first day of April, 1916, executed by the Company to Fidelity Trust Company, of Houston, Texas,
39 (hereinafter called Trustee). For the nature and extent of the security, the rights of the holders of Bonds, of the Trustee and of the Company, and the terms and conditions upon which Bonds are and are to be issued and secured, reference is made to said Trust Agreement, to all the provisions whereof the holder hereof, by accepting this Bond, assents.

The Company is under duty of creating and making payments into a Sinking Fund beginning with the year 1921 and until 1925, inclusive, at the rate of $210,000.00 per annum, upon the basis and according to the terms of said Trust Agreement, for the partial re-

demption of this issue of Bonds at the rate of 105 per cent of the principal amount of Bonds to be retired, and the Company has the privilege of making, on February 1st, of any year, other voluntary contributions to said Sinking Fund in sums of $105,000.00 or multiples thereof, for further redemption of bonds. The Principal of this Bond may be declared due before the due date above expressed in the manner and with the effect provided in said Trust Agreement in case default shall be made and shall continue as therein provided. All rights of action upon this Bond, except as otherwise provided in said Trust Agreement, are vested in the Trustee, and the enforcement thereof is governed by the provisions of said Trust Agreement.

No recourse shall be had for the payment of the principal or interest of this Bond or for any claim based hereon or otherwise in respect hereof against any incorporator or any stockholder, director, or officer, past, present or future, of the Company, either directly or through the Company, by the enforcement of any assessment, call or payment, or through any receiver, assignee or trustee in bankruptcy, or by any other legal or equitable proceedings, whether for amounts unpaid or stock subscriptions or other stock liability of any kind, or whether by virtue of any statute, rule of law, contract, express or implied, representation or otherwise.

Neither this Bond nor any interest coupon pertaining thereto shall be valid or become obligatory for any purpose unless and until the certificate of authentication herein endorsed shall have been duly signed by the Trustee under said Trust Agreement.

In witness whereof, Republic Production Company has caused this Bond to be signed in its corporate name by its President or a Vice President, and its corporate seal to be hereto affixed, duly attested by its Secretary or an assistant Secretary, and the Coupons for said interest bearing the fac-simile signature of its Treasurer to be annexed hereto, all as of the first day of April, A. D. 1916.

REPUBLIC PRODUCTION COMPANY,

By —— ——,

President.

Attest:

—— ——,

Secretary.

(*Form of Interest Coupon.*)

$30.00.

Upon the first day of —— —, ——, Republic Production Company will pay to the bearer at office of Fidelity Trust Company, in Houston, Texas, Thirty Dollars in the United States Gold Coin, being six months interest then to become due upon its Ten Year Six Per Cent Sinking Fund Gold Debenture Bond No. — unless said Bond shall have been called for previous redemption.

W. C. HOGG,

Treasurer.

(*Form of Trustee's Certificate.*)

This Bond is one of the Debenture Bonds described in the within mentioned Trust Agreement.

FIDELITY TRUST COMPANY OF HOUSTON,
Trustee,

By —— ——,
Vice President.

41 "EXHIBIT F."

(*Form of Debenture Bond.*)

United States of America,

$1,000. The State of Texas. $1,000.

No. —.

American Petroleum Company.

Fifteen Year Six per Cent Sinking Fund Gold Debenture Bond.

American Petroleum Company, a corporation of the State of Texas, home office Houston, Texas, hereinafter called Company, for value received, hereby promises to pay to the bearer hereof the sum of One Thousand Dollars in gold coin of the United States of America, of or equal to the present standard of weight and fineness, on the first day of April, A. D. 1931, at the office of Fidelity Trust Company, in Houston, Texas, and to pay interest on said sum from date hereof until the same shall be paid, at the rate of six per cent per annum, payable in like gold coin, such interest until maturity to be payable semi-annually at said office on the first day of October and the first day of April in each year, in accordance with and only upon or after the surrender of the respective coupons for such semi-annual interest as they severally become due.

The Company agrees that it will pay both the principal of and interest upon this Bond without deduction for any taxes, assessments or governmental charges which the Company may be required or permitted to pay thereon or to retain therefrom under any present or future law; provided, the Company will pay, when payable, United States Income Tax, not exceeding one percent on income derived from interest paid hereon.

This Bond is one of an issue of 1,500 coupon Bonds numbered consecutively from 1 to 1500, both inclusive, each of $1,000.00 denomination, all of like terms, date and tenor, aggregating not to exceed One Million Five Hundred Thousand Dollars at any one time outstanding, all issued and to be issued under and equally secured

by a Trust Agreement, dated the first day of April, 1916,
12 executed by the Company to Fidelity Trust Company of Houston, Texas, (hereinafter called Trustee), for the nature and extent of the security, the rights of the holders of Bonds, of the Trustee and of the Company, and the terms and conditions upon which Bonds are and are to be issued and secured, reference is made to said Trust Agreement, to all the provisions whereof the holder hereof, by accepting this Bond, assents.

The Company is under duty of creating and making payments into a Sinking Fund beginning with the year 1926 and until 1930, inclusive, at the rate of $210,000.00 per annum, upon the basis and according to the terms of said Trust Agreement, for the partial redemption of this issue of Bonds at the rate of 105 per cent of the principal amount of Bonds to be retired, and the Company has the privilege of making, on February 1st of any year, other voluntary contributions to said Sinking Fund in sums of $105,000.00 or multiples thereof, for further redemption of bonds. The principal of this Bond may be declared due before the due date above expressed in the manner and with the effect provided in said Trust Agreement in case default shall be made and shall continue as therein provided. All rights of action upon this Bond, except as otherwise provided in said Trust Agreement, are vested in the Trustee, and the enforcement thereof is governed by the provisions of said Trust Agreement.

No recourse shall be had for the payment of the principal or interest of this Bond or for any claim based hereon or otherwise in respect hereof against any incorporator or any stockholder, director or officer, past, present or future, of the Company, either directly or through the Company, by the enforcement of any assessment, call or payment, or through any receiver, assignee or trustee in bankruptcy, or by any other legal or equitable proceedings, whether for amounts unpaid on stock subscriptions or other liability of any kind, or whether by virtue of any statute, rule of law, contract, express or implied, representation or otherwise.

Neither this Bond nor any interest coupon pertaining thereto shall be valid or become obligatory for any purpose unless and until the certificate of authentication hereon endorsed shall have
13 been duly signed by the Trustee under said Trust Agreement.

In witness whereof, American Petroleum Company has caused this Bond to be signed in its corporate name by its President or a Vice President, and its corporate seal to be hereto affixed, duly attested by its Secretary or an Assistant Secretary, and the coupons for said interest bearing the fac-simile signature of its Treasurer to be annexed hereto, all as of the first day of April, A. D. 1916.

AMERICAN PETROLEUM COMPANY,

By —— ——,
President.

Attest:

—— ——,
Secretary.

(*Form of Interest Coupon.*)

$30.00.

Upon the first day of ——, ——, American Petroleum Company, will pay to the bearer at office of Fidelity Trust Company, in Houston, Texas, Thirty Dollars in United States Gold Coin, being six months interest then to become due upon its Fifteen Year Six Per Cent Sinking Fund Gold Debenture Bond No. —, unless said Bond shall have been called for previous redemption.

W. C. HOGG,
Treasurer.

(*Form of Trustee's Certificate.*)

This Bond is one of the Debenture Bonds described in the within mentioned Trust Agreement.

FIDELITY TRUST COMPANY OF HOUSTON,
Trustee,
By —— ——,
Vice President.

44 The foregoing constitutes all of the evidence introduced on said trial by either party. Thereupon, both the plaintiff, and defendant rested.

The Plaintiff thereupon moved for judgment upon the evidence and the defendant, thereupon moved for judgment in his behalf on the ground that the plaintiff's case was unproved.

That thereafter the plaintiff made request of the Court to make special findings of fact and to find as conclusions of law in this action as follows:

In the District Court of the United States for the Southern District of Texas, Sitting at Houston, Texas.

At Law.

No. 320.

J. S. CULLINAN, Plaintiff,

vs.

A. S. WALKER, as Collector of Internal Revenue for the First District of Texas, Defendant.

The Plaintiff above named hereby submits the annexed statement and special findings of facts which he deems proved in this action

and of the conclusions of Law, which he respectfully requests the Court to make in this action.

JOHN WALSH,
BEEMAN STRONG,
Attorneys for Plaintiff.

Dated February 11, 1922.

45 In the District Court of the United States for the Southern District of Texas, Sitting at Houston, Texas.

At Law.

No. 320.

J. S. CULLINAN, Plaintiff,

vs.

A. S. WALKER, as Collector of Internal Revenue for the First District of Texas, Defendant.

The issue joined in this action coming on for trial in its order upon calendar and having been tried before the Court (a jury trial having been waived by the parties in writing) on the 11th day of February, 1922, John Walsh, Esq., W. W. Moore, Esq., Beeman Strong, Esq., and J. Y. Powell, Esq., appearing for the Plaintiff, and D. E. Simmons, Esq., United States Attorney, and Carl E. Matz, Special Attorney for the Bureau of Internal Revenue, appearing for the defendant; and after hearing the allegations and proofs of the parties, the arguments of counsel, and being advised in the premises, I, the Judge, before whom the case was tried, do decide and find as

I. Findings of Fact.

1. Plaintiff, J. S. Cullinan, is now and was at the time of the filing of this suit, and on the various dates and times hereinafter specified, a resident of Houston, Harris County, in the Southern District of Texas.

2. A. S. Walker, designated in this cause as defendant, was at the time of the filing of this suit, and on the various dates and times herein specified, the duly appointed, qualified and acting United States Collector of Internal Revenue, for the District including Harris County, Texas.

3. That Plaintiff, in compliance with the provisions of the Act of Congress of September 8th, 1918, and the Regulations of the United States Treasury Department thereunder, made a return of his annual net income for the twelve months ending De-
46 cember 31st, 1916, as required by said Act and said regulations, and by which return there appeared to be due from the Plaintiff, as income tax for the year 1916 the sum of Three Thou-

sand Nine Hundred and Fourteen and 90/100 ($3,914.90) Dollars, which sum was duly paid by the Plaintiff to the proper authorities.

4. That thereafter the defendant, as such Collector of Internal Revenue, acting under and pursuant to his instructions from the Commissioner of Internal Revenue at Washington, D. C., on the 28th day of December, 1913, mailed notice and demand for an additional income tax claimed by said Collector to be due from the Plaintiff for the said year 1916 in the sum of One Hundred Fifty-Six Thousand, Two Hundred and Twelve and 66/100 ($156,212.66) Dollars, basing such additional tax on certain transactions in which the Plaintiff was involved and which are as follows:

5. Farmers Petroleum Company was incorporated under the laws of the State of Texas on May 1st, 1914, with capital stock of Thirty Thousand Dollars ($30,000.00) divided into Three hundred fully paid shares of the par value of One Hundred ($100.00) Dollars each, fully subscribed and paid for at par in cash at the time, and said company was engaged during the entire period of its existence in the production of petroleum in the State of Texas.

6. By charter amendment duly filed on the 15th day of February, 1915, the capital stock of said Farmers Petroleum Company was increased to One Hundred Thousand Dollars ($100,000.00) consisting of One Thousand (1,000) fully paid shares each of the par value of One Hundred Dollars ($100.00), and the original stockholders subscribed and paid in cash at par on said date for their respective pro rata portions of such increase in the capital stock, all stock of said company being then owned and held as follows:

47 Stockholders.	Shares.	Percentage.
J. S. Cullinan	266.40	$26.64
J. L. Autry	133.20	13.32
W. C. Hogg	133.20	13.32
B. W. Ward	6.66	0.666
Est. of W. B. Sharp	59.94	5.994
T. P. Lee	167.00	16.70
E. F. Woodward	167.00	16.70
C. H. Todd	13.32	1.332
John Slater	13.32	1.332
J. P. Sweeney	13.32	1.332
E. A. Ryan	13.32	1.332
J. L. Considine	13.32	1.332
	1,000.00	100.00

7. That in the latter part of the year 1915, the officers and directors of the Farmers' Petroleum Company, realizing that owing to the great increase in activities of said company, a large amount of credit was necessary, which credit the Farmers Petroleum Company did not have, and that the organization of the Company was not sufficiently adapted or constructed to secure the line or amount of

credit necessary for its business; and it also developed, as the officers and directors of said Farmers Petroleum Company were advised by counsel, that under the laws of the State of Texas, a single corporation could not combine under one charter a producing and pipe line business, which separate businesses it was necessary to conduct in developing the business initiated by said Farmers Petroleum Company.

8. That in order to procure the credit necessary for said business, as it developed and in order that the developing and continuing of the said business and operation thereof, might be in accordance with the laws of the State of Texas, as so advised by counsel, and for no other reasons, the stockholders and directors of the Farmers Petroleum Company formulated a plan of reorganization of Farmers Petroleum Company, which plan contemplated the organization of three corporations; two corporations, one a producing company and one a pipe line company, to be organized under the laws of the State of Texas, and one a holding company to be organized under the laws of the State of Delaware.

9. The balance sheet of the Farmers Petroleum Company, as of February 29, 1916, is as follows:

48

Assets.		
Cash		$78,977.04
Accounts Receivable		9,678.82
Claims		30.86
Unexpired Insurance		14,316.37
General and Office:		
Automobile	$2,244.10	
Engineering & Equipment	391.71	
Furniture & Fixtures	1,866.16	
		4,501.97
Producing department:		
Leases	20,679.17	
Land in fee	2,623.75	
Matagorda Well Equipment	87.50	
Plant and Equipment	284,774.57	
		$408,164.99
Pipe line department:		
Lands in fee	$5,724.52	
Pipe Stocks	2,043.85	
Gathering Lines	6,282.08	
Trunk Lines, Tanks & Equipment	36,285.08	
E. Houston Lines, Tanks & Equipment	697,713.68	
		$799,849.43
Total Assets		$1,215,521.78

Capital and Liabilities.

Unpaid Wages	19.65
Bills Payable	117,380.01
Capital Stock	100,000.00
Surplus	988,122.12
Total	$1,215,521.78

10. In order to make the book figures of its assets coincide with the actual values which, in view of their prospective possibilities, they were believed to have, the books values of the assets of the Farmers Petroleum Company were adjusted as of March 1, 1916, and the values assigned to said assets in connection with their apportionment between the American Petroleum Company and the Republic Production Company, were as follows:

Transferred to Republic Production Co.

Producing Department, Book Value as of February 29, 1916	$308,164.99
Appreciation as of March 1, 1916	2,691,835.01
	$3,000,000.00

Transferred to American Petroleum Co.

General and Office	$4,501.97
Pipe Line Department	799,849.43
Oil Inventories	1,546,850.28
10% appreciation General and Pipe Line	80,435.14
	2,431,636.82
Less accounts payable in the sum of	32,380.14
	2,399,256.81
Oil to be run	600,743.19
	$3,000,000.00

49 In the apportionment by the trustees of the properties between the Republic Production Company and the American Petroleum Company, in order to equalize such apportionment between both of said companies, it was provided that oil of the value of $600,743.19 should be run free of charge from Republic Production Company to American Petroleum Company, which was done.

11. Although the oil in pipe lines and tanks was not carried on the books of the Farmers Petroleum Company as shown in Paragraph 9 above, in the transfer to the American Petroleum Company as of March 1, 1916, an oil inventory of $1,546,850.28 as shown in Paragraph 10 above, was taken into consideration.

12. The result of the above adjustment was to place the book value of the assets of the Farmers Petroleum Company at $6,000,000.00 represented by liabilities as follows:

One Thousand shares of Capital stock.....	$100,000.00
Earned surplus (not taking into consideration oil on hand of the value of $1,546,850.28).....	1,343,105.95
Increase of the book value of assets.....	4,556,894.05
	$6,000,000.00

13. That on the 8th day of November, 1915, pursuant to said plan of re-organization, a certificate of dissolution of the Farmers Petroleum Company was duly filed in the office of the Secretary of State of the State of Texas, the stockholders and relative interest in said Farmers Petroleum Company at said time remaining as above set forth. As a result of which dissolution the directors of said Farmers Petroleum Company at said time, to-wit: the 8th day of November, 1915, viz: said J. S. Cullinan, Jas. L. Autry, T. P. Lee, E. F. Woodward, and W. C. Hogg, who were also owners of substantially all of the stock of said corporation, became by operation of Law "the Trustees in Liquidation of the Farmers Petroleum Company." No formal closing of the books of the Farmers Petroleum Company was had at the time of the filing of said certificate of dissolution, but its affairs and business and accounting was continued by said Trustees until the 8th day of March, 1916.

14. That in pursuance to said plan of reorganization, said
50 trustees divided all of the assets of said Farmers Petroleum Company, into two parts, and on the 8th day of March, 1916, organized two corporations under the laws of the State of Texas: one—Republic Production Company, a producing company, and two—American Petroleum Company, a pipe line company, to take over all the assets and business of said Farmers Petroleum Company. Each of said companies so organized issued upon its organization $1,500,000.00 in capital stock, divided into 15,000 shares, each share of the par value of $100.00, and each also issued at said time $1,500,000.00 in gold debenture bonds, the Republic Production Company bonds payable in ten years and the American Petroleum Company bonds payable in fifteen years, each bond of the denomination of $1,000.00, said bonds being a lien on the respective assets of said corporations. Contemporaneous with the organization of said two new corporations, and in pursuance of said plan of reorganization, said trustees transferred to said Republic Production Company, all the properties of a producing nature that had been owned by the Farmers Petroleum Company, which said properties constituted the entire capital and only assets of said Republic Production Company, and at the same time transferred to American Petroleum Company all the pipe line properties and a certain quantity of crude oil that had been owned by the Farmers Petroleum Company, which constituted the entire capital and only assets of said American Petroleum

Company; and in turn, all of the stocks and bonds of said Republic Production Company and American Petroleum Company, upon their issuance, were delivered to said trustees pending the consummation of said reorganization.

15. That pursuant to said plan of reorganization, a third company, American Republics Corporation, was incorporated under the laws of Delaware, by said Trustees, to exist in the capacity solely of a holding company of the stock of said Republic Production Company and American Petroleum Company, and which said holding company received from said Trustees all of the stock, aggregating Three Million Dollars ($3,000,000.00) par value of said Republic Production Company, and American Petroleum Company such stock constituting its entire capital and only assets. Said holding company thereupon issued and delivered its stock to the
51 amount of Three Million Dollars ($3,000,000.00) par value, consisting of thirty thousand (30,000) fully paid shares, each of the par value of One Hundred Dollars ($100.00) to said Trustees which stock of said holding Company and the said Bonds of the two new Texas corporations were then, in consummation of said plan of reorganization, distributed by said Trustees among the stockholders of the Farmers Petroleum Company in proportion to their respective stock ownership in said Farmers Petroleum Company, all of said stockholders of American Republics Corporation being identical with those of Farmers Petroleum Company upon its dissolution.

16. That the American Petroleum Company and the Republic Production Company had, at the time of the distribution of the stock, of the American Republics Corporation and the bonds of the American Petroleum Company and the Republic Production Company, no assets other than those transferred to each of them respectively by the Trustees in liquidation of the Farmers Petroleum Company, and the assets so transferred were of the same value when the stock of the American Republics Corporation, and the aforementioned bonds were issued and distributed as aforesaid, as they (i. e., said assets) were when held by the said Trustees of the Farmers Petroleum Company.

17. That at and during the period of reorganization, and for a long time prior thereto, the Plaintiff owned in his own right 266.4 shares of the capital stock of the Farmers Petroleum Company, the same representing 26.64 per cent interest in the entire capital stock of said Farmers Petroleum Company, and that Plaintiff received the same percentage of interest in bonds of the said Republic Production Company and American Petroleum Company and stock of said American Republics Corporation.

18. That after said notification and demand for the payment of said additional tax, the Plaintiff filed with said Collector of Internal Revenue an application for the abatement, remission and cancellation of said assessment, which application was denied and the

plaintiff did on the 13th day of January, 1919, pay under protest to said Defendant, A. S. Walker, Collector, said additional income tax so assessed for the period ending December 1916, in the sum of One Hundred Fifty-six Thousand, Two dred and Twelve and 66/100 ($156,212.66) Dollars, and at the time filed with the Defendant, A. S. Walker, a written protest ıst the payment of the same.

. That subsequently the Plaintiff filed with the Defendant A. S. ker, Collector, for presentation to the Commissioner of Internal enue, a claim for the refund of the net amount of the assessment id additional income tax, to-wit: One Hundred Fifty-six Thou-, Two Hundred and Twelve and 66/100 ($156,212.66) Dollars.

. That at the time of the filing of this suit, more than six months the date of filing and presenting said claim for refund to the missioner of Internal Revenue had elapsed, and no action had taken thereon by said Commissioner, but thereafter, to-wit: he 24th day of August, A. D. 1920, said claim was rejected by Commissioner.

. That Plaintiff is not now, nor was he during the times men-ed herein, a member of any stock exchange or of any similar nization or association engaged in the business of trading in, ng or selling stocks, bonds, or other securities, nor was he in way engaged in the business of buying or selling stocks and ls or other securities.

. That the transfer of said properties and the exchange of said ks and bonds, the payment of said additional income tax, the st thereof, and the filing of said claim for refund, occurred in the territory and jurisdiction of the District Court of the ed States for the Southern District of Texas.

. The Government in assessing and collecting the taxes, refund hich is sought in this suit, valued the stock and bonds distributed ne plaintiff, at par. The plaintiff in this suit is not seeking to ver any part of the amount so sued for on account of excessive ation of such stock and bonds.

II. Conclusions of Law.

pon the foregoing findings of fact, I find as conclusions of law,

1. That no income, gain, profit or dividends accrued to the plaintiff from any of the transactions alleged in the amended ion and proved on the trial of this action.

That the shares of stock of the American Republics Corpora- and the bonds of the Republic Production Company and of the erican Petroleum Company, received by the plaintiff, as alleged he amended petition herein, did not under the circumstances titute income and were not subject to taxation as income within

the meaning of the Sixteenth Amendment to the Constitution of the United States, which provides that "Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."

3. That the shares of stock of the American Republics Corporation and the bonds of the Republic Production Company and of the American Petroleum Company received by the plaintiff, as alleged in the Amended petition herein, did not under the circumstances constitute income, gain, profit or dividends and were not subject to taxation within the meaning of the Act of Congress entitled "An Act to Increase the Revenue and for Other Purposes," approved September 8, 1916.

4. That the assessment and collection of the additional taxes, as alleged in the amended petition herein, was not warranted or authorized by the Act of Congress, entitled "An Act to Increase the Revenue and for Other Purposes," September 8, 1916, and therefore were assessed and collected from the plaintiff in violation of the Sixteenth Amendment to the Constitution of the United States.

5. That in so far as said Act of Congress entitled "An Act to Increase the Revenue and for Other Purposes" approved September 8, 1916, purports to authorize the assessment against and collection from the plaintiff of the additional taxes, on account of the receipt by him, of such stocks and bonds, as alleged in the amended petition herein, it conflicts with and violates the terms, meaning and intent of the Sixteenth Amendment to the Constitution of the United States, and to that extent is null and void.

54 6. That the plaintiff is entitled to recover from the defendant the sum of One Hundred and Fifty-Six Thousand, Two Hundred and Twelve and 66/100 Dollars ($156,212.66) with interest at the legal rate of Six per cent per annum from January 8, 1919, together with this costs of action.

Let judgment be entered accordingly.
Dated February 11, 1922.

____ ____,
District Judge.

That upon Plaintiff's motion, that the Court make the foregoing annexed statement and special findings of fact and conclusions of law in said action, as his statement and special findings of fact and conclusions therein, the Court decided said motion as follows:

55 In the District Court of the United States for the Southern District of Texas, Sitting at Houston, Texas.

At Law.

No. 320.

J. S. CULLINAN, Plaintiff,

vs.

A. S. WALKER, as Collector of Internal Revenue for the First District of Texas, Defendant.

The motion of Plaintiff that the Court make the annexed statement and special findings of fact and conclusions of law in the above entitled action coming on to be head, the Plaintiff being represented by his attorneys, John Walsh and Beeman Strong, and the Defendant being represented by D. E. Simmons, United States Attorney and Attorney for Defendant, and the Court being advised in the premises;

It is ordered that the annexed statement and special findings of fact be, and the same is accepted and adopted by the court, as its statement and special findings of fact in the above entitled action;

But the court hereby refuses to accept, adopt or find said annexed conclusions of law, or any of them, and, instead, finds as conclusions of law upon said findings of fact, the converse of each of said conclusions set out in Plaintiff's attached list of findings of fact and conclusions of law, to which action of the court in refusing to adopt said conclusions of law, or any of them, and in making and finding said conclusions of law as so found by the court, the Plaintiff by his attorneys, in open court excepted, which exception was thereupon duly noted and allowed.

(Signed) J. C. HUTCHESON, JR.,
Judge.

56 In the District Court of the United States for the Southern District of Texas, Sitting at Houston, Texas.

At Law.

No. 320.

J. S. CULLINAN, Plaintiff,

vs.

A. S. WALKER, as Collector of Internal Revenue for the First District of Texas, Defendant.

And now comes the above named Plaintiff, and excepts to the findings of the Court as conclusions of law herein:

First. The Plaintiff excepts to the conclusion of the court that there was income, gain, profit or dividends which accrued to the Plaintiff from the transaction alleged in the Amended Petition and proved on the trial of this action.

Second. The Plaintiff excepts to the conclusion of the court that the shares of stock of the American Republics Corporation and the bonds of the Republic Production Company and of the American Petroleum Company, received by the Plaintiff, as alleged in the Amended Petition herein, did under the circumstances constitute income and were subject to taxation as income within the meaning of the Sixteenth Amendment to the Constitution of the United States, which provides that "Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."

Third. The Plaintiff excepts to the conclusion of the court that the shares of stock of the American Republics Corporation and the bonds of the Republic Production Company and of the American Petroleum Company received by the Plaintiff, as alleged in the Amended Petition herein, did under the circumstances constitute income, gain, profit or dividends and were subject to taxation within the meaning of the Act of Congress entitled "An Act to Increase the Revenue and for Other Purposes," approved September 8, 1916.

57 Fourth. The Plaintiff excepts to the conclusion of the Court that the assessment and collection of the additional taxes, as alleged in the Amended Petition herein, was warranted or authorized by the Act of Congress, entitled "An Act to Increase the Revenue and for Other Purposes", approved September 8, 1916, and therefore were assessed and collected from the Plaintiff in violation of the Sixteenth Amendment to the Constitution of the United States.

Fifth. The Plaintiff excepts to the conclusion of the Court that insofar as said Act of Congress entitled "An Act to Increase the Revenue and for other Purposes" approved September 8, 1916, purports to authorize the assessment against and collection from the Plaintiff of the additional taxes, on account of the receipt by him of such stocks and bonds, as alleged in the Amended Petition herein, it does not conflict with or violate the terms, meaning and intent of the Sixteenth Amendment to the Constitution of the United States.

Sixth. The Plaintiff excepts to the conclusion of the Court that the Plaintiff is not entitled to recover from the Defendant the sum of One Hundred and Fifty-six Thousand, Two Hundred and Twelve and 66/100 Dollars ($156,212.66) with interest at the legal rate of Six per cent per annum thereon from January 8, 1919, together with his costs of action.

Seventh. The Plaintiff excepts to the failure of the Court to find, as a conclusion of law, that no income, gain, profit or dividends ac-

ied to the Plaintiff from any of the transactions alleged in the nended Petition and proved on the trial of this action.

Eighth. The Plaintiff excepts to the failure of the court to find a conclusion of law that the shares of stock of the American publics Corporation and the bonds of the Republic Production mpany and of the American Petroleum Company, received by the aintiff, as alleged in the Amended Petition herein, did not under e circumstances constitute income and were not subject to taxation income within the meaning of the Sixteenth Amendment to the nstitution of the United States, which provides that "Congress all have power to lay and collect taxes on incomes, from whatever urce derived, without apportionment among the several States, d without regard to any census or enumeration."

Ninth. The Plaintiff excepts to the failure of the court to find as a conclusion of law that the shares of stock of the nerican Republics Corporation and the bonds of the Republic oduction Company and of the American Petroleum Company re-ved by the Plaintiff, as alleged in the Amended Petition herein, d not under the circumstances constitute income, gain, profit or idends and were not subject to taxation within the meaning of e Act of Congress entitled "An Act to Increase the Revenue and Other Purposes," approved September 8, 1916.

Tenth. The Plaintiff excepts to the failure of the court to find a conclusion of law that the assessment and collection of the ditional taxes, as alleged in the Amended Petition herein, was t warranted or authorized by the Act of Congress, entitled "An t to Increase the Revenue and for Other Purposes," approved otember 8, 1916, and therefore were assessed and collected from e Plaintiff in violation of the Sixteenth Amendment to the Con-ution of the United States.

Eleventh. The Plaintiff excepts to the failure of the Court to find a conclusion of law that insofar as said Act of Congress entitled n Act to Increase the Revenue and for Other Purposes" approved otember 8, 1916, purports to authorize the assessment against d collection from the Plaintiff of the additional taxes, on account the receipt by him of such stocks and bonds, as alleged in the nended Petition herein, it conflicts with and violates the terms, aning and intent of the Sixteenth Amendment to the Constitu-n of the United States, and to that extent is null and void.

Twelfth. The Plaintiff excepts to the failure of the Court to find a conclusion of law that the Plaintiff is entitled to recover from e Defendant the sum of One Hundred and Fifty-six Thousand, o Hundred and Twelve and 66/100 Dollars ($156,212.66) with interest at the legal rate of Six per cent per annum thereon from January 8, 1919, together with his costs of action.

Dated February 11th, 1922.

JOHN WALSH,
BEEMAN STRONG,
Attorneys for Plaintiff.

Which foregoing exceptions were thereupon each duly noted and allowed.

In the District Court of the United States for the Southern District of Texas, Sitting at Houston, Texas.

At Law.

No. 320.

J. S. CULLINAN, Plaintiff,

vs.

A. S. WALKER, as Collector of Internal Revenue for the First District of Texas, Defendant.

It is hereby stipulated and agreed that the foregoing bill of exceptions is true and correct, and that the same may be settled and allowed, and signed and certified as the bill of exceptions to the rulings made and proceedings had on the trial of above entitled action.

Dated this 14th day of February, 1922.

D. E. SIMMONS,
United States District Attorney, Attorney for Defendant.
JOHN WALSH,
BEEMAN STRONG,
Attorneys for Plaintiff.

60 In the District Court of the United States for the Southern District of Texas, Sitting at Houston, Texas.

At Law.

No. 320.

J. S. CULLINAN, Plaintiff,

vs.

A. S. WALKER, as Collector of Internal Revenue for the First District of Texas, Defendant.

Certificate.

And because the foregoing rulings, motions, orders, exceptions and proceedings do not otherwise appear of record, I, the undersigned, the Judge who tried said action, have, on due notice, and after reading the stipulations of the Attorneys for plaintiff and defendant, settled and allowed the foregoing as and for a bill of exceptions, and to the end that the same may be made a part of the record in this case, I do hereby certify that the foregoing, so by me settled and allowed, contains and is all the evidence received and all

e objections, rulings, motions, orders and proceedings had at the ial of said cause, and not otherwise of record herein.

Dated at Houston, Texas, this 15th day of February, 1922.

J. C. HUTCHESON, JR.,
District Judge.

Indorsements: No. 320 at Law. In the U. S. District Court for e Southern District of Texas, Houston, Texas. J. S. Cullinan, laintiff, vs. A. S. Walker, as Collector of Internal Revenue for the irst District of Texas, Defendant. Bill of exceptions. Filed 16 y of Feb. 1922. L. C. Masterson, Clerk, by J. L. Sexton, Deputy.

Assignment of Errors.

Filed Feb. 14, 1922.

the District Court of the United States for the Southern District of Texas, Sitting at Houston, Texas.

At Law.

No. 320.

J. S. CULLINAN, Plaintiff,

vs.

S. WALKER, as Collector of Internal Revenue for the First District of Texas, Defendant.

Assignment of Errors.

Now comes J. S. Cullinan, the plaintiff herein and assigns error in e decision of the United States District Court for the Southern strict of Texas, as follows:

First. The Court erred in rendering judgment for defendant.

Second. The Court erred in not holding that no income, gain, ofit or dividends accrued to the plaintiff from any of the transacns alleged in the amended petition and proved on the trial of this ion.

Third. The Court erred in not holding that the shares of stock of e American Republics Corporation and the Bonds of the Republic oduction Company and of the American Petroleum Company, reved by the plaintiff, as alleged in the amended petition herein, l not under the circumstances constitute income and were not subt to taxation as income within the meaning of the Sixteenth nendment to the Constitution of the United States, which provides at "Congress shall have power to lay and collect taxes, on incomes, om whatever source, derived, without apportionment among the veral States, and without regard to any census or enumeration."

Fourth. The Court erred in not holding that the shares of stock of the American Republics Corporation and the bonds of the Republic Production Company and of the American Petroleum
62 Company received by the plaintiff, as alleged in the amended petition herein, did not under the circumstances constitute income, gain, profit, or dividends and were not subject to taxation within the meaning of the Act of Congress entitled "An Act to Increase the Revenue and for Other Purposes," approved September 8, 1916.

Fifth. The Court erred in not holding that the assessment and collection of the additional taxes, as alleged in the amended petition herein, was not warranted or authorized by the Act of Congress, entitled "An Act to Increase the Revenue and for Other Purposes," approved September 8, 1916, and therefore were assessed and collected *form* the plaintiff in violation of the Sixteenth Amendment to the Constitution of the United States.

Sixth. The Court erred in not holding that in so far as said Act of Congress entitled "An Act to Increase the Revenue and Other Purposes" approved September 8, 1916, purports to authorize the assessment against and collection from the plaintiff of the additional taxes, on account of the receipt by him of such stocks and bonds, as alleged in the amended petition herein, it conflicts with and violates the terms, meaning and intent of the Sixteenth Amendment to the Constitution of the United States, and to that extent is null and void.

Seventh. The Court erred in not awarding judgment to the plaintiff.

Wherefore the plaintiff prays that the judgment of the said District Court be reversed.

JOHN WALSH,
BEEMAN STRONG,
WILLIAM WRIGHT MOORE,
Attorneys for Plaintiff.

Dated February 14th, 1922.

Endorsements: In District Court of the United States for the Southern District of Texas. J. S. Cullinan, Plaintiff, vs. A. S. Walker, as Collector of Internal Revenue for the First District of Texas. Assignment of Errors. Filed 14 day of Feb. 1922. L. C. Masterson, Clerk, by J. L. Sexton, Deputy.

53 *Petition for Writ of Error.*

Filed Feb. 14, 1922.

In the District Court of the United States for the Southern District of Texas, Sitting at Houston, Texas.

At Law.

No. 320.

J. S. CULLINAN, Plaintiff,

vs.

A. S. WALKER, as Collector of Internal Revenue for the First District of Texas, Defendant.

Petition for Writ of Error.

To the United States Supreme Court:

The above named J. S. Cullinan, now appears before this Court and complains that in the records and proceedings had in this cause, and also in the rendition of the judgment in the above entitled cause in the United States District Court, for the Southern District of Texas, on the 11th day of February, 1922, manifest error hath happened to the great damage of said plaintiff, all of which will more in detail appear from the assignment of errors which is filed with this petition.

Wherefore, the said plaintiff hereby prays for the allowance of a writ of error, for an order fixing the amount of the bond for a supersedeas in the said cause, and for such other order and process as may cause the aforementioned errors and judgment to be corrected by said United States Supreme Court.

Dated Houston, Texas, February 14th, 1922.

JOHN WALSH,
WILLIAM WRIGHT MOORE,
BEEMAN STRONG,
Attorneys for Plaintiff.

Endorsements: In the District Court of the United States for the Southern District of Texas. J. S. Cullinan, Plaintiff, vs. A. S. Walker, as Collector of Internal Revenue of the First District of Texas, Defendant. Petition for writ of error. Filed 14 day of Feb. 1922. L. C. Masterson, Clerk, by J. L. Sexton, Deputy.

64 *Order Allowing Writ of Error.*

Filed February 16, 1922.

At a Stated Term of the District Court of the United States Held in and for the Southern District of Texas, at the Courthouse, in the U. S. Post Office, in the City of Houston, State of Texas, on the 15th Day of February, 1922.

Present: Hon. Joseph C. Hutcheson, U. S. District Judge.

At Law.

No. 320.

J. S. CULLINAN, Plaintiff,

vs.

A. S. WALKER, as Collector of Internal Revenue for the First District of Texas, Defendant.

The above named plaintiff, J. S. Cullinan, having filed a petition for a writ of error and an assignment of errors in the above entitled action, and upon filing a bond in the sum of Two Hundred and Fifty Dollars ($250) to be approved by the Court, it is now

Ordered that writ of error be and the same is hereby allowed to have reviewed in the United States Supreme Court the record and proceedings and the judgment heretofore and on the 11th day of February, 1922, rendered in this Court in this cause, and it is

Further ordered that the said bond shall operate as a supersedeas bond.

J. C. HUTCHESON, JR.,
United States District Judge.

Indorsements: No. 320 D. L. In the District Court of the United States for the Southern District of Texas. J. S. Cullinan, Plaintiff, vs. A. S. Walker, as Collector of Internal Revenue of the First District of Texas, Defendant. Order allowing writ of error. Filed 16th day of Feb. 1922. L. C. Masterson, Clerk, by J. L. Sexton, Deputy.

65 *Bond on Appeal and Order of Approval Thereon.*

Filed Feb. 16, 1922.

In the District Court of the United States for the Southern District of Texas, Sitting at Houston, Texas.

At Law.

No. 320.

J. S. CULLINAN, Plaintiff,

vs.

A. S. WALKER, as Collector of Internal Revenue for the First District of Texas, Defendant.

Bond on Appeal.

Know all men by these presents: That J. S. Cullinan as principal, and T. P. Lee and E. F. Woodward, all of Houston, Texas, as sureties, are held and firmly bound unto A. S. Walker as Collector of Internal Revenue for the First District of Texas, in the sum of Two Hundred and Fifty Dollars ($250.00) to be paid to the said A. S. Walker, as Collector of Internal Revenue for the First District of Texas, for the payment of which well and truly to be made, said principal and sureties bind themselves, their heirs executors, administrators and assigns, jointly and severally firmly by these presents. Sealed and dated this 15th day of February, 1922.

Whereas, the above named J. S. Cullinan, has prosecuted a writ of error to the Supreme Court of the United States to reverse the judgment rendered in the above entitled suit, by a Judge of the District Court of the United States for the Southern District of Texas.

Now, Therefore, the condition of this obligation is such, that if the above named J. S. Cullinan will prosecute said writ to effect, and answer all damages and costs, if he fails to make said writ good, then this obligation shall be void, otherwise the same shall

66 be and remain in full force and virtue.

J. S. CULLINAN. [SEAL.]
T. P. LEE. [SEAL.]
E. F. WOODWARD. [SEAL.]

Sealed and delivered in the presence of:
JOHN WALSH.
GAY LUM.

The foregoing bond and surety are approved this 15th day of February, 1922, and the same is accepted as a supersedeas.

J. C. HUTCHESON, JR.,
U. S. District Judge.

Endorsements: No. 320. At Law. In the U. S. District Court for the Southern District of Texas, Houston, Texas. J. S. Cullinan Plaintiff vs. A. S. Walker, as Collector of Internal Revenue for the First District of Texas, Defendant. Bond on appeal and order of approval thereon. Filed 16 day of Feb. 1922. L. C. Masterson, Clerk, by J. L. Sexton, Deputy.

67 *Præcipe.*

Filed Feb. 16, 1922.

In the District Court of the United States for the Southern District of Texas, Sitting at Houston, Texas.

At Law.

No. 320.

J. S. CULLINAN, Plaintiff,

vs.

A. S. WALKER, as Collector of Internal Revenue for the First District of Texas, Defendant.

Præcipe.

To the clerk of the District Court of the United States for the Southern District of Texas:

In accordance with the Writ of Error heretofore sued out to have the judgment of the District Court of the United States for the Southern District of Texas, in cause in said District Court entitled J. S. Cullinan, Plaintiff, vs. A. S. Walker, as Collector of Internal Revenue for the First District of Texas, Defendant, reviewed by the Supreme Court of the United States in and by which Writ of Error you are directed to transmit a true copy of the record and of the assignment of errors and of all the proceedings in said case under your hand and seal of the District Court of the United States for the Southern District of Texas, the Plaintiff in Error therein does now, pursuant to the directions of Rule 8 of the Supreme Court of the United States, hereby request and direct that the following portions of the record be incorporated in the transcript of the record on such Writ of Error, to wit:

1. First Amended Original Petition.
2. The Answer of Defendant.
3. The Bill of Exceptions.
4. Judgment.
5. The Assignment of Errors, filed by the Plaintiff in error.

6. The Petition of J. S. Cullinan, the Plaintiff in Error,
68 for Writ of Error to have said judgment of the District Court of the United States for the Southern District of Texas reviewed by the Supreme Court of the United States, and the Assignment of Errors which accompanied said Petition.

7. Order of the Honorable Joseph C. Hutcheson, Judge of the District Court of the United States for the Southern District of Texas, made on the 15th day of February, 1922, authorizing the issuance of said Writ of Error.

8. Bond filed by said Plaintiff in Error, J. S. Cullinan, on said Writ of Error and to act as a supersedeas.

9. Præcipe of the attorneys for the Plaintiff in Error, J. S. Cullinan, together with acknowledgment of service of a copy thereof, on counsel for the Defendant in Error, indicating the portions of the record to be incorporated into the transcript of the record on the Writ of Error hereinafter referred to.

10. Also the following original papers filed in your office on the 16th day of February, 1922, to-wit:

1. The Original Writ of Error sued out by said J. S. Cullinan as Plaintiff in Error, pursuant to said order, together with the acknowledgment of the service thereof signed by the Defendant's attorney, which said Writ of Error was sued out as aforesaid on the 15th day of February, A. D. 1922.

2. The Original Citation upon said Writ of Error with the acknowledgment of service thereof by the attorney for the Defendant.

Dated February 16-1922.

JOHN WALSH,
W. W. MOORE,
BEEMAN STRONG,
Attorneys for Plaintiff in Error, J. S. Cullinan.

Endorsements: No. 320 at Law. In the U. S. District Court for the Southern District of Texas, Houston, Texas. J. S. Cullinan, Plaintiff, vs. A. S. Walker, as Collector of Internal Revenue for the First District of Texas, Defendant. Præcipe for Transcript of Record. Due personal service of the foregoing præcipe admitted. D. E. Simmons, U. S. District Attorney and Attorney for Defendant in Error. Filed 16 day of Feb. 1922. L. C. Masterson, Clerk, by J. L. Sexton, Deputy.

69 *Clerk's Certificate.*

In the District Court of the United States for the Southern District of Texas, at Houston.

I, L. C. Masterson, Clerk of the District Court of the United States for the Southern District of Texas, in the Fifth Circuit and District

aforesaid, do hereby certify the foregoing to be a true and correct copy of the record, assignments of error and all proceedings had in the case, as called for in the Præcipe for transcript on pages 67 and 68 of said Transcript in Cause No. 230, on the Law Docket of said Court, entitled J. S. Cullinan, Plaintiff, vs. A. S. Walker, as Collector of Internal Revenue for the First District of Texas, Defendant, as the same now appears on file and of record in my office.

To certify which, Witness my hand and the Seal of said Court at Houston, in said District, this the 27th day of February, A. D. 1922.

[Seal of United States District Court, Southern District of Texas.]

L. C. MASTERSON,
Clerk United States District Court,
Southern District of Texas.

70 *Writ of Error.*

UNITED STATES OF AMERICA, *ss:*

The President of United States of America to the Judge of the District Court of the United States for the Southern District of Texas, Greeting:

Because, in the record and proceedings, as also in the rendition of the judgment of a plea which is in the District Court, before you, between J. S. Cullinan, Plaintiff, against A. S. Walker, as Collector of Internal Revenue for the First District of Texas, Defendant, a manifest error hath happened, to the great damage of the said J. S. Cullinan, plaintiff, as is said and appears by his complaint,

We being willing that such error, if any hath been made, should be duly corrected and full and speedy justice done to the party aforesaid in its behalf, Do Command you, if judgment be therein given that then under your seal, distinctly and openly, you send the record and proceedings aforesaid with all things concerning the same to the Supreme Court of the United States, at the City of Washington, District of Columbia, together with this writ, so that you have the same at said place, before the Supreme Court of the United States aforesaid on the 13th day of March, 1922, that the record and proceedings aforesaid being inspected, said Supreme Court of the United States may cause further to be done therein, to correct that error, what of right and according to the law and custom of the United States ought to be done.

Witness, the Honorable William Howard Taft, Chief Justice of the United States, this 16th day of February, 1922, in the year of our Lord one thousand nine hundred and twenty-two and of the Independence of the United States the one hundred and forty-sixth.

[Seal of United States District Court, Southern District of Texas.]

L. C. MASTERSON,
Clerk of the District Court of the United States of America for the Southern District of Texas for the Fifth Circuit.

The foregoing writ is hereby allowed.
J. C. HUTCHESON, JR.,
U. S. District Judge.

½ [Endorsed:] No. 320. At Law. In the U. S. District Court for the Southern District of Texas, Houston, Texas. S. Cullinan, Plaintiff, vs. A. S. Walker, as Collector of Internal venue for the First District of Texas, Defendant. Writ of Error. hn Walsh, William Wright Moore, Beeman Strong, Attorneys for aintiff. Personal service of the within Writ of Error this 16th y of February, 1922, is hereby accepted and admitted. D. E. nmons, U. S. District Attorney and Attorney for Defendant. led 16 day of Feb., 1922. L. C. Masterson, Clerk, by J. L. Sexn, Deputy.

By the Honorable Joseph C. Hutcheson, Jr., Judge of the District Court of the United States for the Southern District of Texas, in the Fifth Circuit, to A. S. Walker, as Collector of United States Internal Revenue for the First District of Texas, Greeting:

You are hereby cited and admonished to be and appear before e United States Supreme Court at a session thereof to be held in e City of Washington, in the District of Columbia, within thirty ys from the date hereof, pursuant to a writ of error filed in the erk's office of the District Court of the United States for the outhern District of Texas, wherein J. S. Cullinan, is plaintiff-in-ror, and you are defendant-in-error, to show cause, if any there be, hy the proceedings and judgment in the said writ of error men-oned, should not be corrected and why speedy justice should not done in that behalf.

Given under my hand in the City of Houston, in the District id Circuit above named, this 16th day of February, in the year our Lord one thousand nine hundred and twenty-two and of the dependence of the United States the one hundred and forty-th.

J. C. HUTCHESON, JR.,
Judge of the District Court of the United States for the Southern District of Texas, Fifth Circuit.

2 [Endorsed:] No. 320. At Law. In the U. S. District Court for the Southern District of Texas, Houston, Texas. J. S. Cullinan, Plaintiff, vs. A. S. Walker, as Collector of In-

ternal Revenue for the First District of Texas, Defendant. Citation on Writ of Error. John Walsh, William Wright Moore, Beeman Strong, Attorneys for Plaintiff. Personal service of the within Writ of Error this 16th day of February, 1922, is hereby accepted and admitted. D. E. Simmons, U. S. District Attorney and Attorney for Defendant. Filed 16 day of Feb. 1922. L. C. Masterson, Clerk, by J. L. Sexton, Deputy.

Endorsed on cover: File No. 28,760. S. Texas D. C. U. S. Term No. 805. J. S. Cullinan, plaintiff in error, vs. A. S. Walker, as collector of internal revenue for the first district of Texas. Filed March 10th, 1922. File No. 28,760.

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IN THE

Supreme Court of the United States

October Term, 1922

No. 301

J. S. CULLINAN,
Plaintiff in Error

vs.

A. S. WALKER, as Collector of Internal Revenue for the First District of Texas.

BRIEF OF PLAINTIFF IN ERROR

This is an action brought in the District Court for the Southern District of Texas against a Collector of Internal Revenue to recover the sum of One Hundred Fifty-Six Thousand, Two Hundred Twelve and 66/100 Dollars ($156,212.66) paid under protest by the plaintiff in error in satisfaction of an assessment made against him by the Commissioner of Internal Revenue of additional income taxes for the year 1916, by reason of the receipt in 1916 by plaintiff in error in a corporate reorganization of certain securities in lieu of other securities held by him.

The action was tried by the Court upon a stipulation of facts, a jury having been waived. (R 15.)

After trial the Court made its findings of fact satisfactory to plaintiff in error and conclusions of law (R 37-45) which conclusions of law were adverse to the plaintiff in error (R 45) and judgment was thereupon entered in favor of the defendant in error (R 13). The trial Judge filed no opinion.

The action is brought to this court by Writ of Error (R 56).

1. STATEMENT OF FACTS

"1. Plaintiff, J. S. Cullinan, is now and was at the time of the filing of this suit, and on the various dates and times hereinafter specified, a resident of Houston, Harris County, in the Southern District of Texas.

"2. A. S. Walker, designated in this cause as defendant, was at the time of the filing of this suit, and on the various dates and times herein specified, the duly appointed, qualified and acting United States Collector of Internal Revenue for the District including Harris County, Texas.

"3. That Plaintiff, in compliance with the provisions of the Act of Congress of

September 8th, 1916, and the Regulations of the United States Treasury Department thereunder, made a return of his annual net income for the twelve months ending December 31st, 1916, as required by said Act and said regulations, and by which return there appeared to be due from the Plaintiff, as income tax for the year 1916, the sum of Three Thousand Nine Hundred and Fourteen and 90/100 ($3,914.90) Dollars, which sum was duly paid by the Plaintiff to the proper authorities.

"4. That thereafter the defendant, as such Collector of Internal Revenue, acting under and pursuant to his instructions from the Commissioner of Internal Revenue at Washington, D. C., on the 28th day of December, 1918, mailed notice and demand for an additional income tax claimed by said Collector to be due from the Plaintiff for the said year 1916 in the sum of One Hundred Fifty-Six Thousand Two Hundred and Twelve and 66/100 ($156,212.66) Dollars, basing such additional tax on certain transactions in which the Plaintiff was involved and which are as follows:

"5. Farmers Petroleum Company was incorporated under the laws of the State of Texas on May 1st, 1914, with capital stock of Thirty Thousand Dollars ($30,000.00) divided into Three hundred fully paid shares of the par value of One Hundred ($100.00)

Dollars each, fully subscribed and paid for at par in cash at the time, and said company was engaged during the entire period of its existence in the production of petroleum in the State of Texas.

"By charter amendment duly filed on the 15th day of February, 1915, the capital stock of said Farmers Petroleum Company was increased to One Hundred Thousand Dollars ($100,000.00) consisting of One Thousand (1,000) fully paid shares each of the par value of One Hundred Dollars ($100.00), and the original stockholders subscribed and paid in cash at par on said date for their respective pro rata portions of such increase in the capital stock, all stock of said company being then owned and held as follows:

Stockholders	Shares	Percentage
J. S. Cullinan	266.40	26.64
J. L. Autry	133.20	13.32
W. C. Hogg	133.20	13.32
B. W. Ward	6.66	0.666
Est. of W. B. Sharp	59.94	5.994
T. P. Lee	167.00	16.70
E. F. Woodward	167.00	16.70
C. H. Todd	13.32	1.332
John Slater	13.32	1.332
J. P. Sweeney	13.32	1.332
E. A. Ryan	13.32	1.332
J. L. Considine	13.32	1.332
	1,000.00	100.00

"7. That in the latter part of the year 1915, the officers and directors of the Farmers Petroleum Company, realizing that owing to the great increase in activities of said company, a large amount of credit was necessary, which credit the Farmers Petroleum Company did not have, and that the organization of the Company was not sufficiently adapted or constructed to secure the line or amount of credit necessary for its business; and it also developed, as the officers and directors of said Farmers Petroleum Company were advised by counsel, that under the laws of the State of Texas, a single corporation could not combine under one charter a producing and pipe line business, which separate businesses it was necessary to conduct in developing the business initiated by said Farmers Petroleum Company.

8. That in order to procure the credit necessary for said business, as it developed, and in order that the developing and continuing of the said business and operation thereof, might be in accordance with the laws of the State of Texas, as so advised by counsel, and for no other reasons, the stockholders and directors of the Farmers Petroleum Company formulated a plan of reorganization of Farmers Petroleum Company, which plan contemplated the organization

of three corporations; two corporations, one a producing company and one a pipe line company, to be organized under the laws of the State of Texas, and one a holding company to be organized under the laws of the State of Delaware.

9. The balance sheet of the Farmers Petroleum Company, as of February 29, 1916, is as follows:

ASSETS

Cash		$78,977.04
Accounts Receivable		9,678.82
Claims		30.86
Unexpired Insurance		14,318.37
General and Office:		
Automobile	$2,244.10	
Engineering & Equipment	391.71	
Furniture & Fixtures	1,866.16	
		4,501.97
Producing Department:		
Leases	$20,679.17	
Land in fee	2,623.75	
Matagorda Well Equipment	87.50	
Plant and Equipment	284,774.57	
		308,164.99

Pipe Line Department:

Lands in fee	$57,524.84	
Pipe Stocks	2,043.85	
Gathering Lines	6,282.08	
Trunk Lines, Tanks and Equipment	36,285.08	
E. Houston Lines, Tanks and Equipment	697,713.68	
		799,849.43
Total Assets		$1,215,521.48

CAPITAL AND LIABILITIES

Unpaid Wages	$19.65
Bills Payable	117,380.01
Capital Stock	100,000.00
Surplus	998,122.12
Total	$1,215,521.78

"10. In order to make the book figures of its assets coincide with the actual values which, in view of their prospective possibilities, they were believed to have, the book values of the assets of the Farmers Petroleum Company were adjusted as of March 1, 1916, and the values assigned to said assets in connection with their apportionment between the American Petroleum Company and the Republic Production Company, were as follows:

TRANSFERRED TO REPUBLIC PRODUCTION CO.

Producing Department, Book Value as of February 29, 1916	$308,164.99
Appreciation as of March 1, 1916	2,691,835.01
	$3,000,000.00

TRANSFERRED TO AMERICAN PETROLEUM CO.

General and Office	$4,501.97
Pipe Line Department	799,849.43
Oil Inventories	1,546,850.28
10% appreciation General and Pipe Lines	80,435.14
	$2,431,636.82
Less accounts payable in the sum of	32,380.14
	$2,399,256.78
Oil to be run	600,743.19
	$3,000,000.00

"In the apportionment by the trustees of the properties between the Republic Production Company and the American Petroleum Company, in order to equalize such apportionment between both of said companies, it was provided that oil of the value of $600,-743.19 should be run free of charge from Republic Production Company to American Petroleum Company, which was done.

"11. Although the oil in pipe lines and tanks was not carried on the books of the Farmers Petroleum Company as shown in Paragraph 9 above, in the transfer to the American Petroleum Company as of March 1, 1916, an oil inventory of $1,546,850.28 as shown in Paragraph 10 above, was taken into consideration.

"12. The result of the above adjustment was to place the book value of the assets of the Farmers Petroleum Company at $600,000.00 represented by liabilities as follows:

One Thousand shares of Capital stock	$100,000.00
Earned surplus (not taking into consideration oil on hand of the value of $1,546,850.28)	1,343,105.95
Increase of the book value of assets	4,556,894.05
	$6,000,000.00

"13. That on the 8th day of November, 1915, pursuant to said plan of re-organization, a certificate of dissolution of the Farmers Petroleum Company was duly filed in the office of the Secretary of State of the State of Texas, the stockholders and relative interest in said Farmers Petroleum Company at said time remaining as above set forth. As a result of which dissolution the directors of said Farmers Petroleum Company

at said time, to wit: the 8th day of November, 1915, viz: said J. S. Cullinan, Jas. L. Autry, T. P. Lee, E. F. Woodward, and W. C. Hogg, who were also owners of substantially all of the stock of said corporation, became by operation of law, "the trustees in Liquidation of the Farmers Petroleum Company." No formal closing of the books of the Farmers Petroleum Company was had at the time of the filing of said certificate of dissolution, but its affairs and business and accounting was continued by said Trustees until the 8th day of March, 1916.

"14. That in pursuance to said plan of reorganization, said trustees divided all of the assets of said Farmers Petroleum Company, into two parts, and on the 8th day of March, 1916, organized two corporations under the laws of the State of Texas: one—Republic Production Company, a producing Company, and two—American Petroleum Company, a pipe line company, to take over all the assets and business of said Farmers Petroleum Company. Each of said companies so organized issued upon its organization $1,500,000.00 in capital stock, divided into 15,000 shares, each share of the par value of $100.00, and each also issued at said time $1,500,000.00 in gold debenture bonds, the Republic Production Company bonds payable in ten years and the American Petroleum Company bonds payable in

fifteen years, each bond of the denomination of $1,000.00, said bonds being a lien on the respective assets of said corporations. Contemporaneous with the organization of said two new corporations, and in pursuance of said plan of reorganization, said trustees transferred to said Republic Production Company, all the properties of a producing nature that had been owned by the Farmers Petroleum Company, which said properties constituted the entire capital and only assets of said Republic Production Company, and at the same time transferred to American Petroleum Company all the pipe line properties and a certain quantity of crude oil that had been owned by the Farmers Petroleum Company, which constituted the entire capital and only assets of said American Petroleum Company, and in turn, all of the stocks and bonds of said Republic Production Company and American Petroleum Company, upon their issuance, were delivered to said trustees pending the consummation of said reorganization.

"15. That pursuant to said plan of reorganization, a third company, American Republics Corporation, was incorporated under the laws of Delaware, by said Trustees, to exist in the capacity solely of a holding company of the stock of said Republic Production Company and American Petroleum Company, and which said holding com-

pany received from said Trustees all of the stock, aggregating Three Million Dollars ($3,000,000.00) par value of said Republic Production Company, and American Petroleum Company, such stock constituting its entire capital and only assets. Said holding company thereupon issued and delivered its stock to the amount of Three Million Dollars ($3,000,000.00) par value, consisting of thirty thousand (30,000) fully paid shares, each of the par value of One Hundred Dollars ($100.00) to said Trustees which stock of said holding Company and the said Bonds of the two new Texas corporations were then, in consummation of said plan of reorganization, distributed by said Trustees among the stockholders of the Farmers Petroleum Company in proportion to their respective stock ownership in said Farmers Petroleum Company, all of said stockholders of American Republics Corporation being identical with those of Farmers Petroleum Company upon its dissolution.

"16. That the American Petroleum Company and the Republic Production Company had, at the time of the distribution of the stock of the American Republics Corporation and the bonds of the American Petroleum Company, and the Republic Production Company, no assets other than those transferred to each of them respectively by the Trustees in liquidation of the Farmers

Petroleum Company, and the assets so transferred were of the same value when the stock of the American Republics Corporation, and the aforementioned bonds were issued and distributed as aforesaid, as they (i. e., said assets) were when held by the said Trustees of the Farmers Petroleum Company.

"17. That at and during the period of reorganization, and for a long time prior thereto, the Plaintiff owned in his own right 266.4 shares of the capital stock of the Farmers Petroleum Company, the same representing 26.64 per cent interest in the entire capital stock of said Farmers Petroleum Company, and that Plaintiff received the same percentage of interest in bonds of the said Republic Production Company and American Petroleum Company and stock of said American Republics Corporation.

"18. That after said notification and demand for the payment of said additional tax, the Plaintiff filed with said Collector of Internal Revenue an application for the abatement, remission and cancellation of said assessment, which application was denied and the Plaintiff did on the 13th day of January, 1919, pay under protest to said Defendant, A. S. Walker, Collector, said additional income tax so assessed for the period ending December 31st, 1916, in the sum of One hundred Fifty-six Thousand, Two

Hundred and Twelve and 66/100 Dollars, and at the same time filed with the Defendant, A. S. Walker, a written protest against the payment of the same.

"19. That subsequently the Plaintiff filed with the Defendant, A. S. Walker, Collector, for presentation to the Commissioner of Internal Revenue, Collector, a claim for a refund of the net amount of the assessment of said additional income tax, to wit: One hundred Fifty-six Thousand, Two Hundred and Twelve and 66/100 ($156,212.66) Dollars.

"20. That the time of the filing of this suit, more than six months from the date of filing and presenting said claim for refund to the Commissioner of Internal Revenue had elapsed, and no action had been taken thereon by said Commissioner, but thereafter, to-wit: on the 24th day of August, A. D. 1920, said claim was rejected by said Commissioner.

"21. The Plaintiff is not now, nor was he during the times mentioned herein, a member of any stock exchange or of any similar organization or association engaged in the business of trading in, buying or selling stocks, bonds, or other securities, nor was he in any way engaged in the business of buying or selling stocks and bonds or other securities.

"22. That the transfer of said properties and the exchange of said stocks and bonds,

the payment of said additional income tax, the protest thereof, and the filing of said claim for refund, occurred within the territory and jurisdiction of the District Court of the United States for the Southern District of Texas.

"23. The Government in assessing and collecting the taxes, refund of which is sought in this suit, valued the stock and bonds distributed to the plaintiff, at par. The plaintiff in this suit is not seeking to recover any part of the amount so sued for on account of excessive valuation of such stock and bonds."

2. SPECIFICATIONS IN ERROR

The errors relied upon, asserted and urged are:

First. The Court erred in rendering judgment for defendant.

Second. The Court erred in not holding that no income, gain, profit, or dividends accrued to the plaintiff from any of the transactions alleged in the amended petition and proved on the trial of this action.

Third. The court erred in not holding that the shares of stock of the American Republics Corporation and the Bonds of the Republic Production Company and of the American Petroleum Company, received by the plaintiff, as alleged in the amended petition herein, did not under the circumstances constitute income and were not sub-

ject to taxation as income within the meaning of the Sixteenth Amendment to the Constitution of the United States, which provides that "Congress shall have power to lay and collect taxes, on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."

Fourth. The Court erred in not holding that the shares of stock of the American Republics Corporation and the bonds of the Republic Production Company and of the American Petroleum Company received by the plaintiff, as alleged in the amended petition herein, did not under the circumstances constitute income, gain, profit, or dividends and were not subject to taxation within the meaning of the Act of Congress entitled "An Act to Increase the Revenue and for Other Purposes," approved September 8, 1916.

Fifth. The Court erred in not holding that the assessment and collection of the additional taxes, as alleged in the amended petition herein, was not warranted or authorized by the Act of Congress, entitled "An Act to Increase the Revenue and for other Purposes," approved September 8, 1916, and therefore was assessed and collected from the plaintiff in violation of the Sixteenth Amendment to the Constitution of the United States.

Sixth. The Court erred in not holding that in so far as said Act of Congress entitled "An Act to Increase the Revenue and Other Purposes" approved September 8, 1916, purports to authorize the assessment against and collection from the

plaintiff of the additional taxes, on account of the receipt by him of such stocks and bonds, as alleged in the amended petition herein, it conflicts with and violates the terms, meaning and intent of the Sixteenth Amendment to the Constitution of the United States, and to that extent is null and void.

Seventh. The Court erred in not awarding judgment to the plaintiff.

ARGUMENT

Plaintiff in error is seeking to recover the sum of $156,212.66 paid to the United States by him under protest in payment of an assessment of additional taxes assessed against him by the Commissioner of Internal Revenue for the year 1916, and the question to be determined by the Court, upon the record, is whether the exchange by claimant of his 26.64 per cent interest in the entire capital assets of the Farmers Petroleum Company for 26.64 per cent of the bonds of the American Petroleum Company and Republic Production Company and 26.64 per cent of the capital stock of the American Republics Corporation, the latter the parent or holding company of the American Petroleum Company and the Republic Production Company, said stocks and bonds having standing behind them only the assets of the Farmers Petroleum Company—the substance—was an exchange of one class of property for a similar class of property and resulted in no taxable income, or

whether the exchange was of one class of property for a different class of property and resulted in taxable income.

On the 8th day of November, 1915, a certificate of dissolution of the Farmers Petroleum Company was duly filed in the Office of the Secretary of State of the State of Texas (R 26). At that time, and for some time prior thereto, plaintiff owned 26.64 per cent of the outstanding capital stock of said corporation, and continued to own said stock until the 8th day of March, 1916, when the Republic Production Company and the American Petroleum Company were organized to take over all the assets and business of said Farmers Petroleum Company.

Each of the two Companies issued upon its organization $1,500,000.00 in capital stock, divided into 15,000 shares, each share of the par value of $100.00, and each also issued at said time $1,500,000.00 in gold debenture bonds, each of the par value of $1,000.00, and the stock and the bonds of these two companies were delivered to the Trustees in Liquidation of the Farmers Petroleum Company pending the consummation of a plan of reorganization of the business of the latter Company.

Pursuant to said plan of reorganization a third company, American Republics Corporation, was incorporated under the laws of Delaware by said Trustees, to exist solely in the capacity of a holding company of the stock of said Republic Production Company and American Petroleum Company. Said holding company received from the Trustees all the stock of the Republic Production Company

and American Petroleum Company, the same consisting of 30,000 shares each of the par value of $100.00 each, and the holding company thereupon issued and delivered its stock, consisting of 30,000 shares each of the par value of $100.00, to said Trustees, which stock of said holding Company and the said bonds of the two new Texas corporations were distributed to the shareholders of the Farmers Petroleum Company according to the same pro rata interest said shareholders had in the stock of the latter company. Thereafter, as appears from the facts in the record, the American Petroleum Company and the Republic Production Company had all the assets of the Farmers Petroleum Company, and the American Republics Corporation owned all the stock of the American Petroleum Company and the Republic Production Company.

The attention of the Court is particularly called to the principal fact in all the transactions growing out of this plan of reorganization to-wit: The stockholders, assets and percentages of interest each stockholder had in the capital assets of the Farmers Petroleum Company remained exactly the same after the reorganization was consummated. In other words, plaintiff's 26.64 per cent of the stock of the American Republics Corporation and 26.64 per cent of the bonds of the American Petroleum Company and Republic Production Company were worth just as much, and no more, than his 26.64 per cent of the stock of the Farmers Petroleum Company. Had the assets of the three new com-

panies been liquidated immediately after the plan of reorganization had been consummated, J. S. Cullinan would have received exactly the same pro rata share in the assets of the Farmers Petroleum Company as he would have received had the three new companies never been created and the Farmers Petroleum Company been liquidated. This is incontrovertible for the simple reason that the assets at all times were identical in every particular and the formation of the three new companies and the dissolution of the old company neither added to nor detracted from the value of the assets.

3. REORGANIZATION

At the outset the attention of the Court is called to the fact that the parties hereto stipulated, and the trial judge found (R. 15-22):

> "8. That in order to procure the credit necessary for said business, as it developed and in order that the developing and continuing of the said business and operation thereof, might be in accordance with the laws of the State of Texas, as so advised by counsel, and for no other reasons, the stockholders and directors of the Farmers Petroleum Company formulated a plan of reorganization of Farmers Petroleum Company, which plan contemplated the organization of three corporations; two corpora-

tions, one a producing company and one a pipe line company, to be organized under the laws of the State of Texas, and one a holding company to be organized under the laws of the State of Delaware.

* * * * * * *

"14. That in pursuance to said plan of reorganization, said Trustees divided all of the assets of said Farmers Petroleum Company into two parts, and on the 8th day of March, 1916, organized two corporations under the laws of the State of Texas; one—Republic Production Company, a producing Company, and two—American Petroleum Company, a pipe line company, to take over all the assets and business of said Farmers Petroleum Company. Each of said companies so organized issued upon its organization $1,500,000.00 in capital stock, divided into 15,000 shares, each share of the par value of $100.00, and each also issued at said time $1,500,000.00 in gold debenture bonds, the Republic Production Company bonds payable in ten years and the American Petroleum Company bonds payable in fifteen years, each bond of the denomination of $1,000.00, said bonds being a lien on the respective assets of said corporations. Contemporaneous with the organization of said two new corporations, and in pursuance of said plan of reorganization, said trustees transferred to said Republic Production

Company all the properties of a producing nature that had been owned by the Farmers Petroleum Company, which said properties constituted the entire capital and only assets of said Republic Production Company, and at the same time transferred to American Petroleum Company all the pipe line properties and a certain quantity of crude oil that had been owned by the Farmers Petroleum Company, which constituted the entire capital and only assets of said American Petroleum Company, and in turn, all the stocks and bonds of said Republic Production Company and American Petroleum Company, upon their issuance, were delivered to said trustees pending the consummation of said reorganization.

"15. That pursuant to said plan of reorganization, a third company, American Republics Corporation, was incorporated under the laws of Delaware, by said Trustees, to exist in the capacity solely of a holding company of the stock of said Republic Production Company and American Petroleum Company, and which said holding company received from said Trustees all of the stock, aggregating Three Million Dollars ($3,000,000.00) par value of said Republic Production Company, and American Petroleum Company such stock constituting its entire capital and only assets. Said holding company thereupon issued and delivered its

stock to the amount of Three Million Dollars ($3,000,000.00) par value, consisting of thirty thousand (30,000) fully paid shares, each of the par value of One Hundred Dollars ($100.00), to said Trustees, which stock of said holding company and the said bonds of the two new Texas corporations were then, in consummation of said plan of reorganization, distributed by said Trustees among the stockholders of the Farmers Petroleum Company in proportion to their respective stock ownership in said Farmers Petroleum Company, all of said stockholders of American Republics Corporation being identical with those of Farmers Petroleum Company upon its dissolution.

"16. That the American Petroleum Company and the Republic Production Company had, at the time of the distribution of the stock of the American Republics Corporation and the bonds of the American Petroleum Company and the Republic Production Company, no assets other than those transferred to each of them respectively by the Trustees in Liquidation of the Farmers Petroleum Company, and the assets so transferred were of the same value when the stock of the American Republics Corporation, and the afore-mentioned bonds were issued and distributed as aforesaid, as they (i. e., said assets) were when held by the said Trustees of the Farmers Petroleum Company.

> "17. That at and during the period of reorganization, and for a long time prior thereto, the Plaintiff owned in his own right 266.4 shares of the capital stock of the Farmers Petroleum Company, the same representing 26.64 per cent interest in the entire capital stock of the said Farmers Petroleum Company, and that Plaintiff received the same percentage of interest in bonds of the said Republic Production Company and American Petroleum Company and stock of said American Republics Corporation."

Not only did the Government stipulate, and the Court find, that the transfer of the assets of the Farmers Petroleum Company to the two operating companies and the exchange of stocks and bonds constituted a corporate reorganization, but that such transfer did as a matter of law constitute a reorganization, is supported by the following:

> "It has been held that where a new corporation was formed by stockholders and directors of an existing corporation, and its directors and practically all of its stockholders, franchises and property were identical with those of the old corporation, the transaction, both in fact and in law, amounted to a reorganization of the old corporation. * * * 14 A Corpus Juris, Section 3603, page 1039, citing Seymour v. Boise R. Co., 24 Idaho, 7; 132 Pac. 427, wherein it was decided as follows:

"Where a new corporation is formed by stockholders and directors of an existing corporation, and the directors of the new corporation are the same persons who were a majority of the directors of the old corporation, and 98 per cent of the issued stock of the new corporation is held by the same persons who were stockholders in the old corporation, and the new corporation purchases all the franchises and property of the old corporation and pays therefor in shares of the capital stock of the new corporation and in cash to the amount of 87½ per cent of the par value of $150,000 worth of first mortgage bonds of the new corporation, *held*, that the transaction amounts in fact and law to a reorganization of the old corporation. * * *"

We quote from the opinion in Silversmiths Company v. Reed & Barton Corporation, 199 Mass. 371, 374, 375, 376; 85 N. E. 433:

"In the case at bar the stock in question was held by a corporation organized under laws which permitted it and another similar corporation to consolidate into a single corporation, and which provided that on such consolidation being consummated, the property of each of the original corporations should vest in the new corporation by force of the statute without deed or other transfer. The question is whether a transmis-

sion of title to the new single corporation under such circumstances and in that way is a 'sale' within the meaning of that word in this by-law.

"It is not technically a sale because the consideration (if there be one) is not money but stocks, and it well may be doubted whether a barter as distinguished from a sale is included within the prohibition of the by-law, because the effect of the by-law is to give the corporation an option on the trade proposed to be made with the outsider.

* * * * * * *

"The transmission of title which took place here is more like a transmission of title by operation of law where a natural person dies intestate than it is like a sale or a barter.

* * * * * * *

"The question here, however, is not what this transmission of title is like. The question is whether such a transmission of title is a sale within the meaning of that word in this by-law.

"The transmission of title now in question was not in fact or in law either a sale or a barter. No consideration, properly speaking, was received by it by way of barter or sale. The old corporations passed out of existence and a new corporation came into being which succeeded to the property of the two corporations which thereby came

to an end. The stock issued to the shareholders of the old corporations was issued and received, not by way of payment or something sold to another but by way of a statement of the interest which those persons who are beneficially interested therein had in the new corporation as the result of the consolidation. * * *

"We are of the opinion that there was no sale of these shares of the old corporations to the new corporation formed by the consolidation within the meaning of that word in this by-law."

(See also Chicago, etc. vs. Austin, 160 Ill. 373, Chicago, etc. Ry. Co. vs. Ferguson, 106 Ill. 358.)

The Government in this case takes the position that each of the corporations involved in the plan of reorganization is a separate and distinct entity apart from the stockholders, but the Government overlooks the fact that for income tax purposes such an entity distinct from its stockholders is such a fiction that a court, whenever necessary, can look beyond the fiction and recognize the stockholders to the end that equity may be done. This doctrine was well supported by the Circuit Court of Appeals, Third Circuit, in Alpha Portland Cement Company vs. U. S., 261 Fed. 339, 340, wherein the Court said:

"It appears that during the year 1909 the defendant purchased certain properties, the

legal title to which was taken in the name of its president, as trustee. Later in the same year, pursuant to a plan for increasing the capital stock of the defendant, these properties were conveyed by the trustee to a corporation known as the Cement Manufacturing Company, which had been formed for the express purpose of thus acquiring and using them in carrying out the recapitalization scheme. The consideration of the conveyance was the issuance by the latter company to the trustee of its entire capital stock, except a few shares necessary, under the laws of the state where the company was incorporated, to be held by the directors. The stock thus issued to the trustee was immediately transferred by him to the defendant, which in turn distributed it among its stockholders, share for share. Thereupon, in furtherance of the recapitalization plan, a merger was effected between the defendant and the Cement Manufacturing Company. For purposes of the merger, the value of properties so conveyed to the Cement Manufacturing Company (which constituted all of its assets) was fixed at the same figure as that at which the trustee had conveyed them to that company; also, before the stock was distributed among the defendant's stockholders, it was formally valued by its directors

at par. The par value of such stock greatly exceeded the price at which the property had originally been purchased by the defendant. The defendant did not include as income in the tax return, which it was required by law to make for that year, the apparent profit resulting from the difference between the price which it had originally paid for the properties and the price at which it had ostensibly sold them to the Cement Manufacturing Company.

* * * * * * *

"From the foregoing recital of facts, it is apparent that while, as a matter of form and of bookkeeping, the defendant did realize a very considerable profit during the tax year in question on the purchase and transfer of these properties, yet in reality it made no profit whatever. The ultimate and real result of the various transactions was that the defendant purchased some properties at one figure, and in working out a plan of recapitalization valued them at a higher figure. The intermediary corporation, to which the legal title of the properties was conveyed by the trustee, was brought into being by the defendant for the express purpose of working out the recapitalization plan, and ceased to exist as a separate entity after that plan had been carried out. The defendant was no richer after the al-

> leged sale than it was before, notwithstanding the book entries, resolutions of directors, transfers of title, etc. Viewed in this light we think that it needs no argument to demonstrate that the case falls within the principle of the decisions of the Supreme Court in Southern Pacific v. Lowe, 247 U. S. 330, 38 Sup. Ct. 540, 62 L. Ed. 1142, and Gulf Oil Corp. v. Lewellyn, 248 U. S. 71, 39 Sup. Ct. 35, 63 L. Ed. 133. Indeed, it cannot be distinguished on principle from the decision of this court in Baldwin Locomotive Works v. McCoach, 221 Fed. 59, 136 C. C. A. 660. Under the above stated facts, considered as a whole, the defendant was therefore not liable for the tax which the government sought to recover in this suit."

While the decision in the above case relates to the Corporation Excise Tax Law of 1909

> "The word 'income' in Corporation Tax Act, imposing an excise tax measured by income, means the same as in prior laws imposing a tax on income. Cleveland C. C. and St. Louis Railway Co. vs. U. S., 242 Fed. 18, affirmed in 247 U. S. 195."

Further, as showing the close relationship between a corporation and its stockholders, the Circuit Court of Appeals in Lynch vs. Turrish, 236 Fed. 653, 656, said

> "It is true that a corporation holds the legal title of, and the right to manage, control and convey, its property, and that a stockholder is without that title and right. But, after all, the corporation is nothing but the hand or tool of the stockholders, in which they hold its property for their benefit. They are the equitable and beneficial owners of all its property, and it is the mere holder or manager of it for them."

And in Macomber vs. Eisner, 252 U. S. 189, the Court said

> "We have no doubt of the power or duty of a court to look through the form of the corporation and determine the question of the stockholder's right, in order to ascertain whether he has received income taxable by Congress without apportionment."

4. THE SIXTEENTH AMENDMENT, STATUTE AND DEPARTMENT REGULATIONS

The Sixteenth Amendment to the Constitution reads as follows:

> "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration."

The provisions of the Revenue Act of 1916 and Article 106 of Regulations 33, revised, on which the Commissioner of Internal Revenue levied and collected the additional tax against plaintiff, in part reads as follows:

> Sec. 1 (a) "That there shall be levied, assessed, collected and paid annually upon the entire net income received in the preceding calendar year from all sources by every individual, a citizen or resident of the United States, a tax of two per centum upon such income.
>
> Sec. 1. (b) "There shall be levied, assessed, collected and paid upon the total net income of every individual—an additional income tax of—(surtax)."
>
> Sec. 2 (a) * * * "The net income of a taxable person shall include gains, profits and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever: Provided, That the term 'dividends' as used in this

title shall be held to mean any distribution made or ordered to be made by a corporation, joint-stock company, association, or insurance company, out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, whether in cash or in stock of the corporation, joint-stock company, association, or insurance company, which stock dividend shall be considered income, to the amount of its cash value."

Regulations 33, Revised:

Art. 106. "Dividend defined.—The term 'dividends' shall be held to mean any distribution made or ordered to be made by a corporation, joint-stock company or association, or insurance company, out of its earnings or profits accrued since March 1, 1913, and payable to its shareholders whether in cash or in stock of the corporation, joint-stock company or association, or insurance company, which stock dividends shall be considered income, to the amount of the earnings or profits so distributed."

The Sixteenth Amendment and the provisions of the Statutes set forth above, for the purposes of taxation, refer to one and the same thing, "income," and what does the 16th Amendment and the subsequent tax statutes mean by "income"?

In Macomber vs. Eisner, 252 U. S. 189, 206, Mr. Justice Pitney, in discussing the scope of the 16th Amendment, in part said:

> * * * "As repeatedly held, this [the 16th Amendment] did not extend the taxing power to new subjects, but merely removed the necessity which otherwise might exist for an apportionment among the states of taxes laid on income." * * *
>
> "A proper regard for its genesis, as well as its very clear language, requires also that this Amendment shall not be extended by loose construction, so as to repeal or modify, except as applied to income, those provisions of the Constitution that require an apportionment according to population for direct taxes upon property, real or personal. This limitation still has an appropriate and important function, and is not to be overridden by Congress or disregarded by the courts."
>
> "In order, therefore, that the clauses cited from article 1 of the Constitution may have proper force and effect, save only as modified by the Amendment, and that the latter also may have proper effect, it becomes essential to distinguish between what is and what is not 'income,' as the term is there used; and to apply the distinction, as cases arise, according to truth and substance, without regard to form. Congress cannot

by any definition it may adopt conclude the matter, since it cannot by legislation alter the Constitution, from which alone it derives its power to legislate, and within whose limitations alone that power can be lawfully exercised."

* * * * * * *

"After examining dictionaries in common use (Bouvier's Law Dict.; Standard Dict.; Webster's Int. Dict.; Century Dict.), we find little to add to the succinct definition adopted in two cases arising under the Corporation Tax Act of August 5, 1909 (36 Stat. at L. 11, chap. 6), (Stratton's Independence vs. Howbert, 231 U. S. 399, 415, 58 L. Ed. 285, 292, 34 Sup. Ct. Rep. 136; Doyle vs. Mitchell Bros. Co., 247 U. S. 179, 185, 62 L. Ed. 1054, 1059, 38 Sup. Ct. Rep. 467); 'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets, to which it was applied in the Doyle Case (pp. 183, 185.)"

"Brief as it is, it indicates the characteristics and distinguishing attribute of income, essential for a correct solution of the present controversy. The government, although basing its argument upon the definition as quoted, placed chief emphasis upon the word 'gain,' which was extended to include a variety of meanings; while the significance

> of the next three words was either overlooked or misconceived,—'*derived-from-capital;*'—'*the gain-derived-from-capital,*' etc. Here we have the essential matter; *not* a gain *accruing* to capital, not a *growth* or *increment* of value in the investment; but a gain, a profit, something of exchangeable value *proceeding* from the property, *severed* from the capital, however invested or employed, and *coming in*, being '*derived,*' that is, *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit, and disposal; *that* is income derived from property. Nothing else answers the description."

While the Government admits, and the lower court found, that the dissolution of the Farmers Petroleum Company and the organization of the three new companies was "a plan of reorganization," it takes the position that stocks or securities in these various corporations are essentially different properties and that a taxable profit is realized if the par value of the stock or securities received in exchange is in excess of the cost of the stock so exchanged.

The contention of the Government is that J. S. Cullinan made and received a taxable profit in 1916, when he received 26.64 per cent of 30,000 shares of stock of the American

Republics Corporation and 26.64 per cent of the Three Million Dollar Debenture Bonds of the American Petroleum Company and Republic Production Company in exchange for 26.64 per cent of the one thousand shares of the old Farmers Petroleum Company, the assets being identical before and after the exchange.

Suppose the converse of this were true and J. S. Cullinan had exchanged 26.64 per cent of the stocks and bonds of the three new companies for 26.64 per cent of the stock of the old Farmers Petroleum Company, the assets being the same before and after the exchange, would J. S. Cullinan have lost anything "severed from the capital" by such an exchange? Would not the 26.64 per cent of the same assets be worth the same whether in one company or three?

If the assets of the Farmers Petroleum Company were worth $6,000,000 just before the plan of reorganization was put into effect, then it is indisputable that Mr. Cullinan owned 26.64 per cent of that amount. If the three new companies, after the plan of reorganization had been put into effect, obtained only the assets of the Farmers Petroleum Company, were these assets not worth exactly what they were worth before the reorganization? If this be so, and we contend it is, how can it be said that J. S. Cullinan had received a taxable profit by reason of the exchange?

It is plain that 26.64 per cent of $6,000,000 of assets in one company is worth only as much as,

but no more than, 26.64 per cent of the same assets in three companies or one hundred companies.

The plan of reorganization herein mentioned was started in November, 1915, and continued up to March 8, 1916, when the plan was consummated. So far as can be ascertained, the tax law of 1916 did not expressly deal with exchanges of stock under corporate reorganizations. In December, 1915, however, the Income Tax Office issued a ruling (T. D. 2274) holding that stock dividends were taxable. It is presumed that this ruling was based upon the Bureau's definition of what constituted "gains, profits, and income derived from * * * dividends, securities, or the transaction of any business carried on for gain or profits, or gains or profits and income derived from any source whatever."

In the cases of Weiss vs. Stearn and Weiss vs. White, 6th Circuit Court of Appeals, January 9, 1923, not yet reported, the question before the Court was whether the defendants in error were, by the District Court, properly regarded, for the purposes of income taxation under the Revenue Act of 1916 (39 Stat. 757) as having disposed with profit of only one-half of their respective stock holdings in the National Acme Manufacturing Company, or whether they should have been considered as though disposed of the entirety.

The facts in these cases show that Stearn and White delivered all of their stock to a trustee. For each share so deposited they later received $150.00 cash and five shares of new stock of the nominal par value of $50.00 each, being in the aggregate,

one-half (250,000 shares) of the stock of a new corporation formed to take over the business of the National Acme Manufacturing Company.

Eastman, Dillon & Company, in order to acquire the other half of the stock of the new corporation, paid to the trustee, $7,500,000, being at the rate of $30.00 per share for 250,000 shares. The vendors and vendees then proceeded to organize a new corporation under the laws of the same State with the same powers and same name, except for the dropping of the word "manufacturing." Its capital stock, $25,000,000, was five times that of the old concern, and was divided into shares of the denomination of $50.00 instead of $100.00 each, as theretofore. The new corporation issued all of its stock to the trustee in exchange for all the assets subject to the liabilities of the old company. The trustee delivered one-half of the shares of the new stock to Eastman, Dillon & Company in consideration of the $7,500,000 paid in and distributed pro rata among the old stockholders, the other half, 250,000 shares, and the $7,500,000, at the agreed rate of $150.00 and five shares of the new for each share of the old stock. The old company was then dissolved and the new corporation continued business under the same management.

The Circuit Court of Appeals in affirming the judgment of the lower court that the excess in the aggregate par value of the new stock did not result in taxable income to the stockholders, said:

"It is clear that the half in question was not sold to Eastman, Dillon & Company. This is true despite the above-quoted language of the first paragraph of the agreement, as substance must dominate form; and what was done, rather than what was agreed to be done, is the final criterion. United States vs. Phellis, 257 U. S., at page 172. As to this half, the legal title never went to Eastman, Dillon & Company, nor beyond the Cleveland Trust Company, which held it for the benefit of the old stockholders, in whom the equity continued until the agreed equivalent in new stock was delivered to them and the old stock retired by the dissolution of the old corporation. Therefore, if the transaction as to this half resulted in taxable gain at all, it was not as the consequence of any sale to Eastman, Dillon & Company, but must be looked for in the transaction had between the old stockholders, the trustee, and the corporation.

The old corporation went through the form of an exchange of its assets for the new stock and a distribution thereof among its shareholders as upon final dissolution. There was nothing that can be properly called a sale of the half of the stock under consideration in any aspect of the case. The question to be decided resolves itself, therefore, to this: Is there taxable income to the stockholder in the receipt of shares of greater face value and actually worth more

than the cost to him of old shares for which they are exchanged upon the occasion of a reorganization accomplished by the taking down of an old corporate structure and the setting up in its place of a new one with the same powers under the laws of the same State, but having greater capital stock, with a taking over of assets subject to liabilities and a continuance of the business under the same management and name?

It is the present policy of Congress, as shown by the statute now in force, to regard such a transaction as non-taxable (Revenue Act of 1921, Ch. 136, p. 230, Sec. 202 (c) (2), although under the Act of 1918 the matter had been made dependent upon the comparative face values of the old and new securities (40 Stats. 1060, Sec. 202 (b). The law of 1916, however, under which this case arises, did not deal expressly with exchanges of stock upon corporate reorganizations, and the case is left to be determined upon the general definition of that which is taxable as "including gains, profits and income derived from * * * business, trade, commerce or sales or dealings in property, whether real or personal * * * also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever." (Section 2(a).)

Except for change of corporate entity

there was here a continuance of the same concern. The assets were the same, and the stockholders (assuming the sale of the other half to have been consummated) were the same, and in the same proportions; the domicile, the powers, the name, substantially, and the corporate obligations were all left as before. The same ends might have been achieved by an amendment of the articles of incorporation providing for the increase of the capital stock, the reduction of the face value of its shares, and the change of name. Had this method of accomplishing the identical result been pursued, the increase in face value of the new certificates issued to the holders in exchange for the old would have been plainly a mere stock dividend, non-taxable under Eisner vs. Macomber, 252 U. S. 189. Therefore, if the transaction be taxable it must be because of the giving up of the old and the taking on of the new charter. It is true that a new corporate being has intervened, but where a corporate entity had been found to be a mere matter of form, it has been disregarded in similar transactions in respect to income taxation. Southern Pacific Co. vs. Lowe, 247 U. S. 330; Gulf Oil vs. Lewellyn, 248 U. S. 71; Alpha Portland Cement Co. vs. United States, 261 Fed. 339; although it is not so when it is a matter of substance. Eisner vs. Macomber and United States vs. Phellis, supra. The latter case, strongly relied upon

by plaintiff in error, does not present a parallel situation. There the surplus has been separated from the capital for the purpose of distributing it among the stockholders in the form of the stock of a new corporation to which the assets were conveyed. But the old corporation continued to exist, its stock remained outstanding, and the segregation of capital from surplus was accomplished by setting over to it assets equal to its capital stock and capable of returning future dividends to its stockholders. In that state of affairs the Supreme Court said of the stockholder: "* * * he could sell his entire portion or any of it" (i. e., his dividend) "without parting with his capital interest in the parent company, or affecting his proportionate relation to the interests of other stockholders. Whether he sold the new stock for money or retained it in preference, in either case when he received it he received as his separate property a part of the accumulated profits of the old company in which previously he had only a potential and contingent interest." Rockefeller vs. United States, 257 U. S. 176, likewise involved a distribution of the stock of a corporation created to take over part of the surplus of the parent corporation while the existence of the latter continued. Peabody vs. Eisner, 247 U. S. 347, exhibited the case of a distribution, as a dividend, of the stock of another corporation held by the

parent company. In each of those cases there was a segregation of accumulated surplus and a distribution of it in the stock of a corporation other than the parent company, both corporations continuing to exist.

In the present case there has been no attempt on the part of the concern to segregate or distribute its surplus, but merely a reorganization accompanied by a stock dividend. It has not been divided into two corporations, one to hold the capital, the other to take the earnings, as in the cited cases. The old charter was surrendered when the new one was taken. The venture of the stockholder in the hazard of the business continues undivided. He has not drawn out his profit. His investment is still entirely in the same enterprise, albeit represented by new certificates, yet essentially the same. For these reasons it is concluded that the distribution upon reorganization of the new stock in exchange for the old did not involve taxable income. Accordingly, the judgment of the District Court is affirmed. (Weiss vs. Stearn, and Weiss vs. White, 6th Circuit Court of Appeals, January 9, 1923.)

The Government has contended in this case that the par value of the stocks and bonds of the three new companies in excess of the par value of the stock of the Farmers Petroleum Company received by J. S. Cullinan was a stock dividend, the excess was income and should be taxed.

5. REORGANIZATION—IN SUBSTANCE A STOCK DIVIDEND

In substance the present case is the case of a stock dividend, and the Government so assumed in its brief filed in the lower court.

In March, 1916, the Farmers Petroleum Company was dissolved and by operation of law all of its assets were turned over to the Officers and Directors, as Liquidating Trustees, such Trustees being practically all of the stockholders of the Farmers Petroleum Company. Immediately thereafter the liquidating trustees (acting as such) organized the Republic Production Company and the American Petroleum Company, each with an authorized capital stock of $1,500,000 and $1,500,000 of 6 per cent Gold Debenture Bonds. The organizers of these two companies then offered the stocks and bonds of the two companies to the Liquidating Trustees (speaking to themselves) for the assets of the Farmers Petroleum Company, and the Liquidating Trustees (speaking to themselves) said "we accept your offer."

Immediately thereafter, the Liquidating Trustees (acting as such) organized the American Republics Corporation with an authorized capital stock of $3,000,000 for the purpose of acting as the holding company of the Republic Production Company and the American Petroleum Company. The organizers of this Company then offered the

$3,000,000 of stock to the Liquidating Trustees (speaking to themselves) for the $3,000,000 of the Republic Production Company and the American Petroleum Company and the Liquidating Trustees (speaking to themselves) said, "we accept your offer." The Liquidating Trustees (being practically all of the stockholders of the Farmers Petroleum Company) then had in their possession all of the stock of the American Republics Corporation ($3,000,000), and all of the bonds of the Republic Production Company and the American Petroleum Company ($3,000,000). The Liquidating Trustees then said to the old stockholders of the Farmers Petroleum Company (again speaking to themselves) "we will exchange the stocks and bonds of the three new companies for the stock you now hold of the Farmers Petroleum Company on the basis of thirty shares of stock of the American Republics Corporation and one and one-half thousand-dollar bonds of the Republic Production Company and the American Petroleum Company for each share of stock in the Farmers Petroleum Company," and the stockholders of the latter company said to the liquidating trustees (speaking to themselves) "we accept your offer." The only property involved in this entire plan of reorganization was the assets of the Farmers Petroleum Company. How could any taxable income, or any income, result to the shareholders in such transactions?

6. APPLICABILITY TO DECIDED CASES

It is the contention of the plaintiff in the case at bar that the plan of reorganization and the exchange of the old stock for the new stock and bonds is governed by the principles decided in the opinion of this Court in Eisner vs. Macomber, 252, U. S. 189 and does not come within the recent opinion of this Court in U. S. vs. Phellis, or U. S. vs. John D. Rockefeller, decided by the Supreme Court, November 21, 1921.

In view of the fact that J. S. Cullinan had filed a claim for refund of the additional tax assessed against him by the Income Tax Office by reason of his exchange of stock of the Farmers Petroleum Company for stock and bonds of the three new companies, and the same was pending in the Income Tax Office at the time the Supreme Court in Eisner vs. Macomber, 252 U. S. 189, decided that stock dividends were not taxable as income, the Tax Office was bound by, and should have followed, the decision in that case, and when the tax office declined to refund the excess tax it was acting in conflict with the reasoning and decision of the Supreme Court in that case.

The plan of reorganization set forth herein was no more than a "book adjustment" of the assets of the Farmers Petroleum Company, which did not result and could not result in a taxable gain to plaintiff. This contention is supported by Macomber vs. Eisner, 252 U. S. 189, 210-212, wherein the Court said:

"If, thereafter the company finds itself in funds beyond current needs, it may declare dividends out of such surplus or undivided profits; * * * the surplus may increase until it equals or even exceeds the par value of the outstanding capital stock. This may be adjusted upon the books in the mode adopted in the case at bar—by declaring a 'stock dividend.' This, however, is no more than a book adjustment, in essence not a dividend, but rather is the opposite; no part of the assets of the company is separated from the common fund, nothing distributed except paper certificates that evidence an antecedent increase in the value of the stockholder's capital interest * * * This, however, is merely bookkeeping that does not affect the aggregate assets of the corporation or its outstanding liabilities; it affects only the form, not the essence, of the 'liability' acknowledged by the corporation to its own shareholders, * * * it does not alter the pre-existing proportionate interest of any stockholder, or increase the intrinsic value of his holding or of the aggregate holdings of the other stockholders as they stood before. The new certificates simply increase the number of the shares, with consequent dilution of the value of each share."

A "stock dividend" shows that the company's accumulated profits have been capi-

talized, instead of distributed to the stockholders or retained as surplus available for distribution in money or kind should opportunity offer. Far from being a realization of profits of the stockholder, it tends rather to postpone such realization, in that the fund represented by the new stock has been transferred from surplus to capital, and no longer is available for actual distribution.

* * * * * * *

Being concerned only with the true character and effect of such a dividend when lawfully made, we lay aside the question whether in a particular case a stock dividend may be authorized by the local law governing the corporation, or whether the capitalization of profits may be the result of correct judgment and proper business policy on the part of its management, and a due regard for the interests of the stockholders. And we are considering the taxability of bona fide stock dividends only.

We are clear that not only does a stock dividend really take nothing from the property of the corporation and add nothing to that of the shareholder, but that the antecedent accumulation of profits evidenced thereby, while indicating that the shareholder is the richer because of an increase of his capital, at the same time shows he has not realized or received any income in the transaction.

That portion of the Court's opinion above which refers to accumulation of profits is not applicable here for the reason that there were no accumulation of profits comparable with the amount of stocks and bonds issued by the three new companies, as will be shown later in this brief.

The excerpts above aptly fit the facts in the case at bar, particularly, wherein the Court said that "no part of the assets of the Company is separated from the common fund," and that "the essential and controlling fact is that the stockholder has received nothing out of the Company's assets for his separate use and benefit, * * * having regard to the very truth of the matter, to substance and not to form, he has received nothing that answers the definition of income within the meaning of the Sixteenth Amendment."

It seems pertinent at this point to refer to the cases of Rockefeller vs. U. S. 257 U. S. 175, and Phellis vs. U. S., decided the same time. The facts in these two cases show that two old corporations received stock from two new corporations in exchange for property conveyed by the old corporations to the new corporations; that subsequently, the old corporations distributed all or part of the stock of the new corporations to the stockholders of the former as a stock dividend. This Court in deciding these two cases held that the stock of the new corporations received by the stockholders in the old corporations was "income" for the reason that the stock of the new corporations was assets in the hands of the old corporations, and when dis-

tributed to the stockholders of the old corporation, they had received something of value for their separate use, severed from the capital of the old corporations, and that the distribution of stock of the new corporations to the stockholders of the old corporations did not in any way lessen the stockholders' proportionate interest in the capital of the old corporations.

A comparison of these two cases with the case at bar at once shows the dissimilarity. Further, the attention of this Court is called to the fact that the Farmers Petroleum Company had no surplus at all comparable with the amount of stocks and bonds issued by the three new companies, the surplus of this company amounting in round figures to $1,000,000, and the difference between the capital stock and surplus and the $6,000,000 of stock and bonds was an appreciation, or writing up, of assets.

If J. S. Cullinan should dispose of his 26.64 per cent of the stock of the American Republics Corporation, with the exception of the same number of par value certificates as he formerly held in the Farmers Petroleum Company, he would no longer have 26.64 per cent interest in the assets of the Republic Production Company and the American Petroleum Company, but, on the other hand, his stock interest would have dwindled to one-thirtieth of his 26.64 per cent stock interest in these assets. Therefore, it is contended that plaintiff's 26.64 per cent of the stock of the American Republics Corporation and

the 26.64 per cent of the bonds of the Republic Production Company and American Petroleum Company do not represent "something severed from the capital" of the Farmers Petroleum Company—they are not "part of the assets of the company separated from the common fund," as held in the Phellis and Rockefeller cases. As pointing out the difference between the case at bar and the Phellis case, we quote the Court from the latter case as follows:

> "* * * he could sell his entire portion, i. e., of the stock received as a dividend, or any of it without parting with his capital interest in the parent company or affecting his proportionate relation to the interests of other stockholders."

It is apparent from the facts stipulated and found by the lower court that plaintiff had not received any cash by reason of his exchange of old stock for the new stock and bonds. Therefore, he could not pay the additional income tax on what the Tax Office asserts to be income without selling stocks and bonds of the new corporations which represent capital, unless possessed of other resources.

See Macomber vs. Eisner, 252 U. S. 189, wherein the Court said:

> * * * "Yet, without selling, the shareholder, unless possessed of other resources,

> has not the wherewithal to pay an income tax upon the dividend stock. Nothing could more clearly show that to tax a stock dividend is to tax a capital increase, and not income, than this demonstration that in the nature of things it requires conversion of capital in order to pay the tax."

In the case at bar the Farmers Petroleum Company was dissolved and the capital or assets of that company went into the Republic Production Company and the American Petroleum Company. Unlike the Rockefeller and Phellis cases, the assets were never in any way distributed to the stockholders—were "never separated from the common fund." The Farmers Petroleum Company did not at any time have a surplus equal to the amount of the stocks and bonds of the two new companies, so that in any event, the distribution of the $6,000,000 of stock and bonds of these two companies to the stockholders of the Farmers Petroleum Company could not have been a distribution based on profits or surplus beyond the actual capital and surplus of the Farmers Petroleum Company.

In the case at bar it cannot be said, as was said in U. S. vs. Phellis:

> * * * "that in substance and fact, as well as in appearance, the dividend received by claimant was a gain and profit derived from his capital interest in the old

> company, not in liquidation of the capital, but in distribution of accumulated profits of the company; something of exchangeable value produced by and proceeding from his investment thereof severed from it and drawn by him for his separate use."

In other words, in the Phellis and Rockefeller cases the stockholders of the old corporations, upon receipt of the stock of the new corporations, had something which represented surplus only of the old corporations "severed from the capital" of the latter. It is plain from the facts found by the Court below that such is not the case at bar. Plaintiff's 26.64 per cent of the stocks and bonds of the new companies represents his identical interest in both the capital and surplus of the Farmers Petroleum Company, not "severed from the capital" of the Farmers Petroleum Company or its successor corporations.

7. SUBSEQUENT TAX STATUTES AND DEPARTMENT REGULATIONS

Having shown the inconsistencies of the rulings of the Income Tax Office as applied to the Income Tax Act of 1916, it is interesting to note the trend of subsequent income tax statutes, and regulations promulgated by the tax office in accordance therewith, and this is done for the purpose of showing this Court that by reason of the inconsistencies in the construction of the early tax statutes and the injustice done to citizens thereby, the need of corrective legislation in such matters has been steadily progressive.

Section 202 (b) of the Revenue Act of 1918 reads in part as follows:

> "When property is exchanged for other property, the property received in exchange shall for the purpose of determining gain or loss be treated as the equivalent of cash to the amount of its fair market value, if any; but when in connection with the reorganization, merger, or consolidation of a corporation a person receives in place of stock or securities owned by him new stock or securities of no greater aggregate par or face value, no gain or loss shall be deemed to occur from the exchange, and the new stock or securities received shall be treated as taking the place of the stock, securities, or property exchanged.

Excerpts from the following Articles of Regulations 45 of the Income Tax Office, explaining in part the attitude of the Tax Office with respect to the interpretation of Section 202 (b), are as follows:

Article 1564, page 242:

> "(a) The amount of income derived in the case of an exchange of property, as of stock for a bond, is the excess of the fair market value at the time of exchange of the bond received in exchange over the original cost of the stock exchanged for it. * * * (b) On the other hand, if the property received in exchange is substantially the same property *or has no market value*, then no gain or loss is realized, but the new property is to be regarded as substituted for the old and upon a sale of the new property the amount of income derived is the excess of the amount so received over the cost or fair market value as of March 1, 1913, of the old."

Article 1565, page 243:

> "* * * (b) If property is exchanged for two different kinds of property, such as bonds and stock, neither having a market value, the cost or fair market value as of March 1, 1913, of the original property should be apportioned, if possible, between the bonds and stock for the purpose of de-

termining gain or loss on *subsequent sales.* If no fair apportionment is practicable, no profit on any subsequent sale of any part of the bonds or stock is realized until out of the proceeds of sales shall have been recovered the entire cost or fair market value as of March 1, 1913, of the original property."

Article 1566, page 243:

"(a) Where property is transferred to a corporation in exchange for its stock, if the previous owner of the property receives 50 per cent or more of the stock of the corporation, so that an interest of 50 per cent or more in such property remains in him, then no gain or loss is realized by such owner from the transaction. For the purpose of ascertaining the gain or loss from the subsequent sale by the stockholder of any stock so received for such property the stock is to be considered as substituted for the property, and the cost of the property or (if acquired prior thereto) its fair market value as of March 1, 1913, is the basis for determining the amount of such gain or loss. * * * 'Owner' includes 'owners.' * * * (b) If, however, the exchange of property and stock involves less than 50 per cent of the stock of the corporation, the exchange constitutes a closed transaction, and the former owner of the property realizes a gain

or loss if the stock has a market value and such market value is greater or less than the cost or (if acquired prior thereto) the fair market value as of March 1, 1913, of the property given in exchange. (c) Where a corporation dissolves and distributes its assets in kind and not in cash no taxable income is received from the transaction by its stockholders, because they merely exchange an indirect interest for a direct interest in the same property. * * *"

This Article was later amended by the Income Tax Office to read as follows:

"Where property is transferred to a corporation in exchange for its stock, the exchange constitutes a closed transaction and the former owner of the property realizes a gain or loss if the stock has a market value, and such market value is greater or less than the cost or the fair market value as of March 1, 1913 (if acquired prior thereto), of the property given in exchange. For the rule applicable where a corporation, in connection with a reorganization, merger, or consolidation, exchanges property for stock, see article 1567."

Article 1567, page 244.

"In general, where two (or more) corporations unite their properties by either

(a) the dissolution of corporation B and the sale of its assets to corporation A, or (b) the sale of its property by B to A and the dissolution of B, or (c) the sale of the stock of B to A and the dissolution of B, or (d) the merger of B into A, or (e) the consolidation of the corporations, no taxable income is received from the transaction by A or B or the stockholders of either, provided the sole consideration received by B and its stockholders in (a), (b), (c), and (d) is stock or securities of A, and by A and B and their stockholders in (e) is stock or securities of the consolidated corporation, in any case of no greater aggregate par or face value than the old stock and securities surrendered. If the stock so received has no nominal or par value the limitation on aggregate par value is inapplicable."

The Revenue Act of 1921.

"Sec. 202 (a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; except that—"

* * * * * * *

"(c) For the purposes of this title, on an exchange of property, real, personal or mixed, for any other such property, no gain

or loss shall be recognized unless the property received in exchange has a readily realizable market value; but even if the property received in exchange has a readily realizable market value, no gain or loss shall be recognized—

* * * * * * *

"(2) When in the reorganization of one or more corporations a person receives in place of any stock or securities owned by him, stock or securities in a corporation a party to or resulting from such reorganization. The word 'reorganization,' as used in this paragraph, includes a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or of substantially all the properties of another corporation), recapitalization, or mere change in identity, form or place of organization of a corporation (however effected); or

"(3) When (A) a person transfers any property, real, personal or mixed, to a corporation, and immediately after the transfer is in control of such corporation, or (B) two or more persons transfer any such property to a corporation, and immediately after the transfer are in control of such corporation, and the amounts of stock, securities, or both, received by such persons are in sub-

stantially the same proportion as their interests in the property before such transfer. For the purposes of this paragraph, a person is, or two or more persons are, 'in control' of a corporation when owning at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

"(d) (1) Where property is exchanged for other property and no gain or loss is recognized under the provisions of subdivision (c), the property received shall, for the purposes of this section, be treated as taking the place of the property exchanged therefor, except as provided in subdivision (e):"

* * * * * * *

"Art. 1564. EXCHANGE OF PROPERTY. Gain or loss arising from the acquisition and subsequent disposition of property is realized only when as the result of a transaction between the owner and another person the property is converted into other property (a) that is essentially different from the property disposed of, and (b) that has a readily realizable market value." * * *

"Art. 1566. EXCHANGE OF PROPERTY WHICH RESULTS IN NO GAIN OR LOSS. Where property is exchanged for other property, even if the property re-

ceived in exchange has a readily realizable market value, no gain or loss is recognized:

* * * * * * *

"(b) When in the reorganization of one or more corporations a person receives in place of any stock or securities owned by him, stock or securities in a corporation a party to or resulting from such reorganization. The word 'reorganization' as used in this paragraph includes a merger or consolidation (including the acquisition by one corporation of at least a majority of the outstanding voting stock and at least a majority of the total number of outstanding shares of all other classes of stock of another corporation, or of substantially all the properties of another corporation), recapitalization, or mere change in identity, form, or place of organization of a corporation, however effected. Under this paragraph it makes no difference whether the stock or securities received are or are not of a like kind or class. So long as the property received in the reorganization consists of stock or securities within the usual meaning and acceptation of these terms no gain or loss is recognized. Where two or more corporations unite their properties, by either (1) the dissolution of corporation B and the sale of its assets to corporation A, or (2) the sale of its property by B to A, or (3) the sale of the stock of B to A, or (4)

the merger of B into A, or (5) the consolidation of A and B, or (6) the acquisition by A of a majority of the voting stock and a majority of the total number of shares of all other classes of stock of B or of substantially all of the properties of B, no taxable income is received from the transaction by A or B or by the stockholders of either corporation A or corporation B, provided the sole consideration received by the stockholders is stock or securities of corporations A or B or any corporation a party to or resulting from the reorganization. Where in connection with an internal adjustment of the affairs of a corporation, either by recapitalization or a change in identity, form, or domicile (however effected), a person receives in place of the stock or securities owned by him new stock or securities of the corporation, no gain or loss is realized." (See examples cited in Regulations.)

"Art. 1567. GAIN OR LOSS FROM SUBSEQUENT SALE.—(a) Where property is exchanged for other property and no gain or loss is recognized under Articles 1564 or 1566 the property received shall for the purpose of determining gain or loss from its subsequent sale be treated as taking the place of the property exchanged therefor."

It will be seen from the above that Congress by

additional legislation, and the Tax Department by broader interpretative regulations, are constantly striving to conform to the opinion of the Supreme Court in Eisner vs. Macomber, 252 U. S. 189, particularly, as to what constitutes "income." It is clear from a study of Section 202 (a), and subsections thereto, of the Revenue Act of 1921, that if the transactions involved in the plan of reorganization put into effect by the trustees in liquidation of the Farmers Petroleum Company and its stockholders had taken place in 1921 the Tax Office would have held that the exchange did not result in a taxable gain to the stockholders until said stockholders had subsequently disposed of the new stock and securities for other property equivalent to cash. This being so, no taxable income could have resulted to said stockholders in any year prior to 1921 because, as stated by this Court in Eisner vs. Macomber, 252 U. S. 189, 206.

> "* * * it becomes essential to distinguish what is and what is not 'income,' as the term is there used; and to apply the distinction, as cases arise, according to truth and substance, without regard to form. Congress cannot by any definition in the matter adopted, conclude the matter, since it cannot by legislation alter the Constitution from which alone it derives its power to legislate, and within whose limitations alone that power can be lawfully exercised."

And again at page 207, the Court defines income as

> "* * * a gain, a profit; something of exchangeable value, *proceeding from* the property, *severed from* the capital, however invested or employed, and *coming in*, being *derived*, that is *received* or *drawn by* recipient (the tax payer), for his *separate* use, benefit and disposal; *that* is income derived from property. Nothing else answers the description."

We contend that as the exchange of stock of the Farmers Petroleum Company for the stocks and bonds of the new companies were predicated on the same assets, no income was "realized' or could be "recognized," and therefore the assessment and collection of the additional tax, based, as it was, on the misconception of what constitutes "income," is contrary to the Sixteenth Amendment and in conflict with the opinion of this Court in Eisner vs. Macomber, 252 U. S. 189.

The inconsistency and failure of the Tax Office to differentiate between what is and what is not a taxable gain arising out of reorganizations and exchanges of stocks and securities for other stocks and securities in connection therewith, is due to the fact that the tax office has *not* given full credit to "substance," instead of "form." For instance, the office overlooks the fact that exchanges of stocks and securities, such as took place in the plan of reorganization in the case at bar, was not an

exchange of stocks and securities by one person with another person, but was only an exchange by a group of individuals with themselves. In other words, the office overlooks the fact that the exchange which took place in this case was not made with individuals separate and distinct from the holders of the stock of the old Farmers Petroleum Company, but were made only with themselves, involved only the same identical assets, and could not have resulted in a gain simply by reason of the plan of reorganization put into effect by said individuals.

The plan of reorganization was initiated by the stockholders of the Farmers Petroleum Company, and involved only the assets of that company. The stockholders were the same throughout the entire transaction. Nothin was acquired by the new companies but the assets of the Farmers Petroleum Company. The old company was dissolved. The reorganization was chiefly to legally operate under the laws of the State of Texas. The stockholders of the Farmers Petroleum Company got together and agreed, particularly on account of the Texas statute hereinbefore referred to, that the business of the old corporation should, in the future, be carried on by two new operating companies, and that the two new companies should be controlled by a parent or holding company. The mere fact that the stockholders agreed among themselves to issue an amount of stock greatly in excess of what they owned in the Farmers Petroleum Company and, in addition, to issue a large

amount of debenture bonds of the new companies, could not by this mere fact alone have resulted in income to the old stockholders of the Farmers Petroleum Company. If such an act could bring about income to the recipients, then there would be no limit to what these stockholders could have obtained by simply issuing to themselves unlimited amount of debenture bonds. But when it is considered that the assets of the new companies were identical to the assets of the old Farmers Petroleum Company, it is at once perceivable that after the plan of reorganization was put into effect the old stockholders were no richer nor poorer than they had been before the plan became operative.

Further, it is here asserted that there was no distribution of dividends within the meaning of the 1916 Income Tax Law or subsequent tax statutes for the reason that the Farmers Petroleum Company at no time had accumulated a surplus equal to the amount of stocks and bonds issued by the new companies. This contention is supported by an excerpt from Article 1545 of Regulations 45, which reads as follows:

> "* * * But stock distributions made out of surplus other than earnings or profits accumulated since February 28, 1913, when there are no such earnings or profits, are not dividends within the meaning of the statute and are free from tax as dividends."

In other words, while the tax office holds that the plan of reorganization was a sale of the assets by the Farmers Petroleum Company to the Republic Production Company and the American Petroleum Company for the stocks and bonds of these two companies, and that the exchange of the old stock for the new stock and bonds was a stock dividend, it is clear from an examination of the statutes and the regulations promulgated by the Department that the dividend could not have been predicated on earnings or profits accumulated since February 28, 1913, or at any time thereafter because there were no such earnings or profits equal to the new stocks and bonds issued by the new companies.

8. BONDS NOT INCOME

Having shown, as we believe beyond question, that the exchange of the old stock of the Farmers Petroleum Company for the new stock of the American Republics Corporation, the holding Company of the Republic Production Company and the American Petroleum Company, did not and could not under the circumstances set forth in the plan of reorganization result in a taxable gain to the stockholders, the question naturally arises as to whether the $3,000,000 of bonds issued by the two operating companies and turned over to the stockholders of the Farmers Petroleum Company, constituted income to said stockholders within the meaning of the Sixteenth Amendment.

It having been clearly pointed out, as we think, in this brief that the plan of reorganization did not result in a sale, that the stockholders of the old Company at all times during the reorganization dealt only with themselves, that no assets other than those of the Farmers Petroleum Company were involved under the plan, that the earnings and profits, together with the capital of the Farmers Petroleum Company, did not at any time equal the amount of the stocks and bonds issued by the new Companies to the stockholders of the old company, it seems pertinent now to show the Court that the bonds of the two operating companies coming into the hands of the stockholders of the Farmers Petroleum Company did not constitute income in any manner whatsoever. In the beginning it may be asked in what way does a dividend or a distribution of this type differ from a stock dividend? For example, suppose that a company with an accumulated surplus of $100,000, issues a pro rata dividend for this amount in ten-year 6 per cent bonds, the transaction would be recorded by a charge to surplus and a credit to the bonds account. This transaction would not disturb the totals of the balance sheet. No assets are eliminated and the total of the equities is unchanged. The operation simply results in a reduction in one equity heading and an equal increase in another. The only important difference between this and the stock dividend is that the character of an interest has been changed. The same people are involved but they have two kinds of rights in the

assets of the corporation. Until the date of the payment of the bonds is reached the effect upon the company is substantially the same as that resulting from a stock dividend, aside from the increase in the interest charges.

The position of the stockholder is not changed by the occurrence. While he holds the corporation's promise to pay, he has received no corporate asset. A dividend bond is on a level with a stock certificate, and to realize on either, it would be necessary to sell, assign or hypothecate the securities.

It is true that the bonds of the two operating companies constitute a lien on the assets of said companies. BUT WHO OWNS THE ASSETS? The record shows that the American Republics Corporation owns all the stock of these two operating companies, and therefore, it is the equitable and beneficial owner of the assets of these two companies. AND WHO OWNS THE ASSETS OF THE AMERICAN REPUBLICS CORPORATION? The holders of the bonds of the two operating companies, and therefore, they are the equitable and beneficial owners of the assets of the American Republics Corporation. This contention is supported by an excerpt from the opinion in the case of Lynch vs. Turrish, 236 Fed. 657 (C. C. A.) wherein the Court said:

> "It is true that a corporation holds the legal title of, and the right to manage, control and convey its property, and that a

> stockholder is without that title and right. But, after all, the corporation is nothing but the hand or tool of the stockholders, in which they hold its property for their benefit. They are the equitable and beneficial owners of all its property, and it is the mere holder or manager of it for them.

The bonds being a lien against the assets of the operating companies and the assets being owned by the bondholders, one offsets the other. If the holders of the bonds sell them, the purchasers thereof must be reimbursed later on out of the profits derived from the business, or the conversion of the assets. Further, these bonds until retired, naturally reduce the actual value of the assets of the operating companies, because the bonds are a lien on the assets. Further, the interest on said bonds is a preferred lien on the earnings of the operating companies, and to that extent the dividend paying prospects of the operating companies are reduced, and this, of course, reduces the actual value of the stocks of the operating companies owned by the American Republics Corporation and thereby reduces the actual value of the stock of the latter company owned by the holders of the bonds.

9. CONCLUSION

From the facts set forth herein we contend that plaintiff received no taxable income by reason of

his exchange of 26.64 per cent of the stock of the Farmers Petroleum Company for 26.64 per cent of the stock and bonds of the three new companies, having in mind the dominating fact *that the assets were identical before and after the plan of reorganization.* However, we respectfully request the Court in its final determination of the case at bar to consider the doctrine laid down by this Court in Macomber vs. Eisner, 252 U. S. 189, Gulf Oil vs. Lewellyn, 248 U. S. 71, and Southern Pacific Co. vs. Lowe, 247 U. S. 330, and look "to substance and not to form," to the end that this Court will be convinced that plaintiff "has received nothing that answers the definition of income within the meaning of the Sixteenth Amendment."

We, therefore, assert that the Income Tax Office in deciding that the plaintiff's 26.64 per cent of the stocks and bonds of the new companies resulted in income, ignored "substance" in the plan of reorganization, to wit: the assets of the Farmers Petroleum Company, and took into consideration only the form of the three new companies.

We also contend that the plan of reorganization did not constitute a sale, and was not in "substance" an exchange, but was a reorganization, as admitted by the Government, by which the business of the Farmers Petroleum Company was to be carried on thereafter.

If the Farmers Petroleum Company before dissolution had issued additional capital stock to the amount of $5,900,000 and distributed said stock to its stockholders in the form of a stock dividend,

and the stockholders had exchanged said stock for the $6,000,000 of stocks and bonds of the new companies, this Court, in accordance with its opinion in Eisner vs. Macomber, and the opinion of the Circuit Court of Appeals in Weiss vs. Stearn and Weiss vs. White, 6th Circuit Court of Appeals, January 9, 1923, would hold that such an exchange resulted in no taxable income to the stockholders. If this contention be correct, then we assert that the plaintiff could not by reason of the plan of reorganization have received any taxable income as a result of his transfer *to himself* of 26.64 per cent of the stocks and bonds of the new companies for his 26.64 per cent of the stock of the Farmers Petroleum Company, the assets throughout the entire transaction being identical. The assets are "the substance" and remain the same throughout the entire plan of reorganization.

Plaintiff in error therefore submits that the tax imposed is unfair, confiscatory, and not supported by the Constitution, and that the Income Tax Act of 1916 so far as it purports to support or authorize said tax is in violation of the Sixteenth Amendment to the Constitution, and that the judgment of the District Court should be reversed.

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In the Supreme Court of the United States

OCTOBER TERM, 1921.

J. S. CULLINAN, PLAINTIFF IN ERROR,
v.
A. S. WALKER, AS COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF TEXAS, DEFENDANT IN ERROR. } No. 805.

IN ERROR TO THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF TEXAS.

BRIEF FOR DEFENDANT IN ERROR.

STATEMENT OF THE CASE.

This is an action at law against the defendant as Collector of Internal Revenue for the First District of Texas to recover the amount paid him as additional income tax for the year 1916, under the provisions of the Revenue Act of September 8, 1916. To the complaint the defendant interposed a general denial, and, a jury trial having been waived, the cause was submitted to the court on an agreed statement of facts contained in two stipulations dated, respectively, February 19, 1921, and February 22, 1921. The plaintiff thereupon requested the court to make

certain special findings of facts and conclusions of law. The court found the facts as requested by plaintiff, but found the converse of each conclusion of law which plaintiff submitted. On these findings a judgment was rendered and entered for the defendant. From this judgment plaintiff brings error.

There is but one question involved in the case, viz.: Did the transaction involved result in taxable income to the plaintiff? The latter concedes that if it did, the amount of such income was properly determined by the Bureau of Internal Revenue and the correct amount of tax collected thereon. Any question as to the correct valuation of the various stocks and bonds involved is therefore eliminated.

FINDINGS OF FACTS.

The District Court found the facts to be substantially as follows:

The defendant was at all times material to the case Collector of Internal Revenue for the First District of Texas. The plaintiff, in compliance with the provisions of the Revenue Act of September 8, 1916, and the regulations of the United States Treasury Department thereunder, made an income tax return for the calendar year 1916, under which there appeared to be due from plaintiff an income tax of $3,914.90, which sum was duly paid. Thereafter, on December 28, 1916, the defendant, as such Collector, made demand upon plaintiff for the sum of $156,212.66 as additional income tax for the period in question. This sum the plaintiff, on January 13,

1919, paid under protest, filed his claim for refund, and, more than six months having elapsed without action thereon by the Commissioner of Internal Revenue, this suit was brought. Subsequent to the filing of the suit the claim was rejected.

The additional tax thus assessed and collected was based on the following facts and transactions:

The Farmers Petroleum Co. was incorporated under the laws of Texas on May 1, 1914, with a capital stock of $30,000 divided into 300 fully paid shares of the par value of $100 each, fully subscribed and paid for at par *in cash* at the time. On February 15, 1915, the capital stock of the corporation was increased to $100,000 consisting of 1,000 fully paid shares each of the par value of $100, the original stockholders each subscribing and paying in cash and at par for his pro rata share of such increase. Of these 1,000 shares, the plaintiff, Cullinan, then owned 266.40 or 26.64 per centum of the entire issued capital.

In the latter part of 1915 the officers and directors of the company decided that its organization was not sufficiently adapted or constructed to secure the line of credit necessary for its business, and legal counsel advised that under the laws of Texas a single corporation could not continue under one charter an oil-producing and a pipe line business, which separate businesses it was necessary to conduct in developing the business initiated by the Farmers Petroleum Co.

In order, therefore, to provide the necessary credit and conduct the business in accordance with the laws of Texas, and for no other reason, the stockholders and directors formulated a plan for the reorganization of the company, which contemplated the organization of three new corporations; two corporations, one a producing and the other a pipe line company to be organized under the laws of Texas; and the third, a holding company to be organized under the laws of Delaware.

The balance sheet of the Farmers Petroleum Co., as of February 29, 1916, is as follows:

Assets.

Cash		$78,977.04
Accounts Receivable		9,678.82
Claims		30.86
Unexpired Insurance		14,316.37
General and Office:		
Automobile	$2,244.10	
Engineering & Equipment	391.71	
Furniture & Fixtures	1,866.16	
		4,501.97
Producing department:		
Leases	20,679.17	
Land in fee	2,623.75	
Matagorda Well Equipment	87.50	
Plant and Equipment	284,774.57	
		408,164.99
Pipe line department:		
Lands in fee	5,724.52	
Pipe Stocks	2,043.85	
Gathering Lines	6,282.08	
Trunk Lines, Tanks & Equipment	36,285.08	
E. Houston Lines, Tanks & Equipment	697,713.68	
		799,849.43
Total Assets		1,215,521.78
Capital and Liabilities:		
Unpaid Wages		19.65
Bills Payable		117,380.01
Capital Stock		100,000.00
Surplus		988,122.12
Total		1,215,521.78

In order to make the book figures of its assets coincide with the actual values which, in view of their prospective possibilities they were believed to have, the book values of the assets of the Farmers Petroleum Co. were adjusted as of March 1, 1916. The values assigned to said assets in connection with their apportionment between the American Petroleum Co. and the Republic Production Co. (the two new Texas corporations) were as follows;

Transferred to Republic Production Co.	
Producing Department, Book Value as of February 29, 1916	$308,164.99
Appreciation as of March 1, 1916	2,691,835.01
	3,000,000.00
Transferred to American Petroleum Co.	
General and Office	4,501.97
Pipe Line Department	799,849.43
Oil Inventories	1,546,850.38
10% appreciation General and Pipe Line	80,435.14
	2,431,636.82
Less accounts payable in the sum of	32,380.14
	2,399,256.81
Oil to be run	600,743.19
	3,000,000.00

In the apportionment of the properties by the trustees between the Republic Production Co. and the American Petroleum Co., and in order to equalize such apportionment, it was provided that oil of the value of $600,743.19 should be run free of charge from the Republic Production Co. to the American Petroleum Co.,—which was done.

Although the oil in pipe lines and tanks was not carried on the books of the Farmers Petroleum Co., in the transfer to the American Petroleum Co., as

of March 1, 1916, an oil inventory of $1,546,850.28 was taken into consideration. The result of the above adjustment was to place the book value of the assets of the Farmers Petroleum Co. at $6,000,000 represented by liabilities as follows:

1,000 shares of capital stock	$100,000.00
Earned surplus (not taking into consideration oil on hand of the value of $1,546,850.28)	1,343,105.95
Increase of the book value of assets	4,556,894.05
	6,000,000.00

On November 8, 1915, pursuant to said plan of reorganization, a certificate of dissolution of the Farmers Petroleum Co. was duly filed in the office of the Secretary of State of Texas, the stockholders and their relative interests in the Farmers Petroleum Co. at such time remaining as above set forth. As a result of such dissolution, the directors of the Farmers Petroleum Co. on the day of dissolution became by operation of law "The Trustees in liquidation of the Farmers Petroleum Co." No formal closing of the books of the Farmers Petroleum Co. was had at the time of the filing of the certificate of dissolution, but its affairs and business accounting were continued by said Trustees until March 8, 1916.

In pursuance of said plan of reorganization, the Trustees divided all the assets of the Farmers Petroleum Co. into two parts and on March 8, 1916, organized two new corporations under the laws of the State of Texas; (1)—Republic Production Co.—a producing company; and (2)—American Petroleum Co.—a pipe line company, to take over all the assets and business of the Farmers Petroleum Co.

Each of said companies issued upon its organization $1,500,000 in capital stock divided into 15,000 shares of the par value of $100, and $1,500,000 in gold debenture bonds; the Republic Production Co. bonds payable in ten years, and the American Petroleum Co. bonds in fifteen years, each bond of the denomination of $1,000. These bonds were a lien upon the assets of the respective corporations. Contemporaneous with the organization of the two new corporations, the Trustees transferred to the Republic Production Co. all of the properties of a producing nature that had been owned by the Farmers Petroleum Co., which properties constituted the entire capital and only assets of the Republic Production Co., and at the same time transferred to the American Petroleum Co. all the pipe line properties and a certain quantity of crude oil that had been owned by the Farmers Petroleum Co., which constituted the entire capital and only assets of the American Petroleum Co.; and, in turn, all of the stocks and bonds of the two new corporations, upon their issuance, were delivered to the Trustees, pending the consummation of the reorganization.

Pursuant to said plan of reorganization, a third corporation, the American Republics Corporation, was incorporated by said Trustees, under the laws of Delaware, to exist in the capacity solely of a holding company of the stocks of the Republic Production Co. and the American Petroleum Co. The holding company then received from the Trustees

all of the stock aggregating $3,000,000 par value of the Republic Production Co. and the American Petroleum Co., such stocks constituting its entire capital and only assets. The holding company thereupon issued and delivered its stock in the amount of $3,000,000 par value consisting of 30,000 fully paid shares each of the par value of $100, to the Trustees. The stock of the holding company and the bonds of the two new Texas corporations were thereupon distributed by the Trustees among the stockholders of the Farmers Petroleum Co., in proportion to their respective stock ownership in the latter corporation.

At the time of the distribution of these stocks and bonds the American Petroleum Co. and Republic Production Co. had no assets other than those transferred to them by the Trustees in liquidation of the Farmers Petroleum Co., and the assets so transferred had the same value at the time of such distribution as when held by the Trustees of the Farmers Petroleum Co.

At and during the period of reorganization and for a long time prior thereto, the plaintiff owned in his own right 266.4 shares of the capital stock of the Farmers Petroleum Co., the same representing 26.64% of the entire capital stock of the latter company, and plaintiff received the same percentage of the bonds of the Republic Production Co. and the American Petroleum Co. and stock of the American Republics Corporation.

ASSIGNMENTS OF ERROR.

The appellant assigns as error:

"First. The Court erred in rendering judgment for defendant.

"Second. The Court erred in not holding that no income, gain, profit or dividends accrued to the plaintiff from any of the transactions alleged in the amended petition and proved on the trial of this action.

"Third. The Court erred in not holding that the shares of stock of the American Republics Corporation and the bonds of the Republic Production Company and of the American Petroleum Company, received by the plaintiff, as alleged in the amended petition herein, did not under the circumstances constitute income and were not subject to taxation as income within the meaning of the Sixteenth Amendment to the Constitution of the United States, which provides that 'Congress shall have power to lay and collect taxes, on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.'

"Fourth. The Court erred in not holding that the shares of stock of the American Republics Corporation and the bonds of the Republic Production Company and of the American Petroleum Company received by the plaintiff, as alleged in the amended petition herein, did not under the circumstances constitute income, gain, profit, or dividends and were not subject to taxation within the meaning of the Act of Congress entitled

'An Act to Increase the Revenue and for Other Purposes,' approved September 8, 1916.

"Fifth. The Court erred in not holding that the assessment and collection of the additional taxes, as alleged in the amended petition herein, was not warranted or authorized by the Act of Congress, entitled 'An Act to Increase the Revenue and for Other Purposes,' approved September 8, 1916, and therefore were assessed and collected from the plaintiff in violation of the Sixteenth Amendment to the Constitution of the United States.

"Sixth. The Court erred in not holding that in so far as said Act of Congress entitled 'An Act to Increase the Revenue and Other Purposes' approved September 8, 1916, purports to authorize the assessment against and collection from the plaintiff of the additional taxes, on account of the receipt by him of such stocks and bonds, as alleged in the amended petition herein, it conflicts with and violates the terms, meaning and intent of the Sixteenth Amendment to the Constitution of the United States, and to that extent is null and void.

"Seventh. The Court erred in not awarding judgment to the plaintiff."

STATUTE.

The pertinent provisions of the Revenue Act of September 8, 1916, are as follows:

"Sec. 1. (a) That there shall be levied, assessed, collected, and paid annually upon the entire net income received in the preced-

ing calendar year from all sources by every individual, a citizen or resident of the United States, a tax of two per centum upon such income; * * *

"(b) In addition to the income tax imposed by subdivision (a) of this section (herein referred to as the normal tax) there shall be levied, assessed, collected, and paid upon the total net income of every individual, * * * an additional income tax (herein referred to as the additional tax) of one per centum per annum upon the amount of which such total net income exceeds $20,000 and does not exceed $40,000, * * * (and further additional tax graduated according to the amount of net income).

"For the purpose of the additional tax there shall be included as income the income derived from dividends on the capital stock or from the net earnings of any corporation, * * *

"All the provisions of this title relating to the normal tax on individuals, so far as they are applicable and are not inconsistent with this subdivision and section three, shall apply to the imposition, levy, assessment, and collection of the additional tax imposed under this subdivision.

"(c) The foregoing normal and additional tax rates shall apply to the entire net income except as hereinafter provided, received by every taxable person in the calendar year nineteen hundred and sixteen and in each calendar year thereafter.

"Sec. 2. (a) That, subject only to such exemptions and deductions as are hereinafter

allowed, the net income of a taxable person shall include gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever: Provided, That the term 'dividends' as used in this title shall be held to mean any distribution made or ordered to be made by a corporation, joint-stock company, association, or insurance company, out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, whether in cash or in stock of the corporation, joint-stock company, association, or insurance company, which stock dividend shall be considered income, to the amount of its cash value. * * *

"Sec. 5. That in computing net income in the case of a citizen or resident of the United States— * * *

"(b) For the purpose of the normal tax only, the income embraced in a personal return shall be credited with the amount received as dividends upon the stock or from the net earnings of any corporation, * * * which is taxable upon its net income as hereinafter provided; * * *

"Sec. 8. (a) The tax shall be computed upon the net income, as thus ascertained, of each person subject thereto, received in each preceding calendar year ending December thirty-first."

ARGUMENT.

Introductory.

By reference to the Findings of Fact it will be noted that upon the organization of the Farmers Petroleum Co. the appellant purchased for cash at par 26.64% of the capital stock then issued and that later, when the capital of the corporation was increased from $30,000 to $100,000, he purchased for cash at par his proportionate part of the new issue. This, of course, made him a purchaser and holder for cash at par of 26.64% of the entire capital stock outstanding after the increase in capitalization; that is to say, 26.64% of $100,000. This stock he continued to hold until the corporation was dissolved and, having been purchased at par, its cost to him was $26,640.

The Findings of Fact further state that upon the dissolution of the Farmers Petroleum Co. there were distributed to its stockholders all of the stock of the American Republics Corporation and all the bonds of the Republic Production Co. and the American Petroleum Co.; that the par value of the stocks of the American Republics Corporation was $3,000,000 and the total par value of the bonds issued by the Republic Production Co. and the American Petroleum Co. $3,000,000; and that these stocks and bonds were distributed to the stockholders of the Farmers Pe-

troleum Co. in proportion to their shareholdings in the latter company. The appellant, therefore, received 26.64% of the $3,000,000 stock of the holding company and the same proportionate part of the $3,000,000 bonds of the other two new corporations.

There was collected from him a surtax computed upon the profit represented by the difference between the total par value of the stocks and bonds received upon dissolution and the cost to him of his shares in the Farmers Petroleum Co. The par value of the stocks and bonds so received was $1,598,400 and the cost of his shares in the Farmers Petroleum Co. $26,640. The taxable profit was, therefore, $1,571,760.

The appellant is not seeking to recover any part of the amount so sued for on account of excessive valuation of such stocks and bonds.

Section 1(a) of the Revenue Act of 1916 provides that there shall be levied, assessed, collected and paid annually upon the *entire net income* received in the preceding calendar year *from* all sources by every individual, a resident of the United States, a normal tax of two per centum upon such income. Section 1(b) provides for an additional tax on total net income in excess of $20,000, graduated according to the amount of such excess, with a further provision that for purposes of the additional tax there shall be included as part of the net income the income derived from dividends on the capital stock or from the net earnings of any corporation. Section 2(a) provides that subject to certain exemp-

tions and deductions the net income of a taxable person shall include "gains, profits, and income derived from * * * sales or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from * * * dividends * * * or gains or profits and income derived from any source whatever."

It will be noted from the above that the Act levies an income tax upon dividends specifically and upon sales or dealings in property, whether real or personal, and upon "*gains or profits and income derived from any source whatever.*" It is clear that if plaintiff received any income in any form as a result of the transaction in question, that income comes within the terms of the Act and is taxable.

The Sixteenth Amendment to the Federal Constitution provides:

> "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."

It is equally clear that the Sixteenth Amendment authorizes the taxation without apportionment and without regard to any census or enumeration of everything coming within the meaning of the term "income." To express it differently, the Amendment applies to all income, and Congress intended in the Act here involved to exert its power to the

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extent permitted by the Amendment. *Eisner* v. *Macomber*, 252 U. S. 189, 203.

We come, therefore, to the ultimate question to be decided in this case, which may be briefly stated as follows:

Did the transaction involved in this suit result in taxable income to the plaintiff?

a. *The case is governed by United States* v. *Phellis, 257 U. S. 156, and Rockefeller* v. *United States, 257 U. S. 176.*

The appellant contends that this transaction did not result in income to him within the meaning of the Sixteenth Amendment. The respondent, on the other hand, contends that it did.

The same question has been determined adversely to the appellant's contention by this Court in the recent cases of *United States* v. *C. W. Phellis*, 257 U. S. 156, and *John D. Rockefeller* v. *United States*, 257 U. S. 176.

The facts in the case of *United States* v. *Phellis* were as follows:

An income tax for the year 1915 was collected from Phellis upon alleged income equivalent to the market value of 500 shares of stock of a Delaware corporation called E. I. du Pont de Nemours and Co. received by him as a dividend on his 250 shares of stock of the E. I. du Pont de Nemours Powder Co., a New Jersey corporation. In and prior to September, 1915, the New Jersey Company had been engaged for many years in the business of manufacturing and selling

explosives. Its funded debt and its capital stock at par value were as follows:

5% mortgage bonds	$1,230,000
4½% 30-year bonds	14,166,000
Preferred stock ($100 shares)	16,068,600
Common stock ($100 shares)	29,427,100
Total	60,891,700

It had an excess of assets over liability showing a surplus of accumulated profits more than sufficient to cover the dividend distribution presently to be mentioned. In that month a reorganization and financial adjustment of the business was resolved upon and carried into effect with the assent of a sufficient proportion of the stockholders. A new corporation was formed under the laws of Delaware with an authorized capital stock of $240,000,000 to consist in part of debenture stock bearing 6% cumulative dividends, and in part of common stock; and to this new corporation all the assets and good will of the New Jersey corporation were transferred as an entirety and as a going concern as of October 1, 1915, at a value of $120,000,000, the new company assuming all the obligations of the old except its capital stock and funded debt. In payment of the consideration the old company retained $1,484,100 in cash to be used in redemption of its outstanding 5% mortgage bonds, and received $59,661,700 par value in debenture stock of the new company (of which $30,234,600 was to be used in taking up, share for share and dollar for dollar, the preferred stock of the old company and redeeming its 30-year bonds), and $58,854,200, par value of the common

stock of the new company which was to be and was immediately distributed among the common stockholders of the old company as a dividend, paying them two shares of the new stock for each share they owned in the old company. This plan was carried out by appropriate corporate action. Each holder of the New Jersey company's common stock (including Phellis) retained his old stock and besides received a dividend of two shares for one in common stock of the Delaware company, and the New Jersey corporation retained in its treasury 6% debenture stock of the Delaware corporation equivalent to the par value of its own outstanding common stock. The personnel of the stockholders and officers of the two corporations was on October 1, 1915, identical, the new company having elected the same officers as the old. The holders of the common stock in the two corporations had the same proportionate stockholding in each. After the reorganization and the distribution of the stock of the Delaware corporation the New Jersey corporation continued as a going concern and was still in existence at the time the case came on for trial; but except for the redemption of its outstanding bonds, the exchange of debenture stock for its preferred stock, and the holding of debenture stock to an amount equivalent to its own outstanding common, and the collection and disposition of dividends thereon, it had done no business. It was not, however, in process of liquidation. It had received as income on the Delaware company's debenture stock held by it, dividends to the amount

of 6% per annum, which it had paid out to its own stockholders, including Phellis. The fair market value of the stock of the New Jersey corporation on September 30, 1915, prior to reorganization, was $795 per share, and its fair market value after the execution of the contracts between the two corporations was on October 1, 1915, $100 per share. The fair market value of the stock of the Delaware corporation distributed as aforesaid was on October 1, 1915, $347.50 per share. The Commissioner of Internal Revenue held that the 500 shares of Delaware company stock acquired by plaintiff on the distribution was income of the value of $347.50 per share, and assessed the additional tax accordingly.

It was contended on behalf of Phellis: first, that the transaction there in question involved merely a financial reorganization and the stock received by him was not income, and that the new shares received by him represented nothing more than additional evidence of his ownership of the corporate assets; second, that the effect of the transaction was the same as if a stock dividend had been issued and therefore not taxable as income. The court rejected these contentions and held the tax properly collected.

The argument of the Court in support of its holding is both exhaustive and sound. It may be summarized as follows:

. The transfer of the old company's assets to the new company in exchange for securities issued by

the latter, and the distribution of those securities by the old company among its stockholders was a mere distribution of corporate surplus in the form of an ordinary dividend. By the distribution the individual stockholders received assets of exchangeable and actual value severed from their capital interest in the old company for their separate use and benefit, which might be disposed of by them without changing or in any way affecting their capital investment in the old corporation. To hold otherwise would be to regard the old and the new company as substantially identical, a conclusion which the court was not willing to accept. The fact that a comparison of the market value of the stockholder's shares in the New Jersey corporation immediately before, with the aggregate market value of his shares plus the dividend shares immediately after the dividend, showed no gain in the aggregate, does not prove that the dividend did not constitute income, for the reason that this is the normal and necessary effect of all dividend distributions. The suggestion that the new shares received by the stockholder represented nothing more than additional evidence of his ownership of the same assets must be discarded as not only contrary to the facts, but as involving a disregard of the separate corporate identity of the old and new companies.

The case of *Rockefeller* v. *United States*, 257 U. S. 176, was decided on the same day as *United States* v.

Phellis, and upon authority of the latter case. The facts in the former were as follows:

In and prior to the year 1914 the Prairie Oil and Gas Co., a corporation of the State of Kansas, was engaged in producing, purchasing, and selling crude petroleum and transporting it through pipe lines owned by the company in parts of Kansas and Oklahoma and elsewhere. At the same time the Ohio Oil Co., a corporation of the State of Ohio, was engaged in producing and manufacturing petroleum and mineral oil and transporting the same through pipe lines owned by it in the States of Ohio, Indiana, Illinois, and Pennsylvania. In June, 1914, it was judicially determined by the Supreme Court in the pipe line cases, 234 U. S. 548, that with respect to the transportation business these companies were common carriers in interstate commerce subject to the Act to Regulate Commerce as amended and as such subject to the supervision of the Interstate Commerce Commission. By the Act of September 26, 1914, the remainder of their business became subject to the supervision of the Federal Trade Commission. In order to avoid a probable conflict of Federal authority, in case the combined business of production and transportation should continue to be carried on as theretofore, it was in each case, upon advice of counsel, determined that the pipe line property should be owned and operated by a separate corporation.

In the case of the Ohio company an added reason for segregation lay in the fact that by a section of

the Ohio General Code its entire gross receipts, including those derived from business other than transportation, were subject to an annual assessment of 4% chargeable against the gross receipts of companies engaged in the transportation business. For these reason, the stockholders of the Prairie Oil and Gas Co. caused a corporation to be organized under the laws of the State of Kansas, by the name of the "Prairie Pipe Line Co.," to which all the pipe line property of the Prairie Oil and Gas Co. was transferred in consideration of the issue and delivery of the entire capital stock of the new company, to be distributed *pro rata* to the stockholders of the Prairie Oil and Gas Company. And similarly, the stockholders of the Ohio Oil Co. caused a corporation to be formed under the laws of that State, by the name of the "Illinois Pipe Line Co.," to which all the pipe line property of the Ohio Oil Co. was transferred in consideration of the issue to it of the entire capital stock of the new company, which was to be distributed at once by the old company to its stockholders *pro rata*. These arrangements were carried out in like manner in both cases. The aggregate valuation of the Prairie pipe lines was $27,000,000, that of the Ohio pipe lines $20,000,000 and the total capitalization of the respective pipe line companies equalled these amounts.

In each case the oil company had a surplus in excess of the stated value of its pipe lines and of the par value of the total stock of the corresponding pipe line company; so that the transfer of the pipe

lines and the distribution of the stock received for them left the capital of the respective oil companies unimpaired and required no reduction in their outstanding issues.

Rockefeller was a holder of large amounts of stock of both the Prairie and the Ohio oil companies and in the distribution received an amount of stock in each of the pipe line companies proportionate to his holdings in the oil companies. This occurred in the year 1915. None of Mr. Rockefeller's stock in the pipe line companies was sold by him. An income tax assessment for the year 1915 was imposed upon him based upon the value of the stock thus received as dividends.

Except on one point, these two cases (*U. S.* v. *C. W. Phellis* and *John D. Rockefeller* v. *U. S.*) are on all fours with the instant case. The substantial identity of facts is so striking that any discussion of them would appear superfluous. Indeed, so very striking is it that in his brief in the District Court the plaintiff, himself, after commenting upon the similarity of the facts in the cases relied most strongly on the *Phellis case*, which had not at that time reached this Court, but which had been decided in the taxpayer's favor by the Court of Claims. In *United States* v. *Phellis* the old corporation exchanged all of its assets for part of the stock (but all of the stock issued at that time) of the new corporation and distributed the latter's stock to its shareholders, retaining only enough that its capital was not impaired. In *Rockefeller* v. *United States* the old corporation ex-

changed a part of its assets for all the stock of the new company and distributed all the latter stock to the old concern's shareholders, its other retained assets being sufficient to cover its outstanding capital stock. In the case at bar the old company exchanged all its assets for all the stocks and bonds of the new concerns and distributed the whole to its own shareholders. The one point of difference lies in this: that in both the *Phellis* and the *Rockefeller cases* the distribution which was subjected to tax was made as a dividend in a going corporation, whereas, in the case now under consideration the tax was levied upon a distribution of surplus made at the time and as a part of a distribution of both capital and surplus in final liquidation.

Is this a vital or material difference? In the case of *United States* v. *Phellis*, 257 U. S. 156, at p. 169, it is said:

> "* * * Hence the inquiry must be whether the shares of stock in the new company received by claimant as a dividend by reason of his ownership of stock in the old company constituted (to apply the tests laid down in *Eisner* v. *Macomber*, 252 U. S. 189, 207), a gain derived from capital, not a gain accruing to capital, nor a growth or increment of value in the investment, but a gain, a profit, something of exchangeable value proceeding from the property, severed from the capital however invested, and coming in, that is, received or drawn by the claimant for his separate use, benefit and disposal."

The particular distribution made in that case was held to comply with this test. If there is any distinction between the *Phellis case* and the case at bar growing out of the form of distribution, it must be based on the theory that, while in both cases there has been a gain to the stockholder, the gain to him in the case of a final distribution represents simply a gain accruing to capital or a growth or increment of value of the investment, which has not been severed from his capital or received by him for his separate use, benefit, and disposal; or, in other words, that in the case at bar there has been a gain but no severance or realization of such gain—no severance from the capital out of which it grew or to which it accrued.

To approach this question intelligently, it is necessary to determine first whether or not there is any distinction between a distribution by way of ordinary corporate dividend and a distribution in final liquidation.

Two different views on this point have been advanced. One regards the surrender of his shares by a stockholder and the receipt by him of his proportionate part of the corporate assets by way of final distribution and liquidation as a sale or exchange of the old shares for the cash or property, as the case may be, which is distributed on liquidation. According to this view, an ordinary dividend and a distribution on final liquidation are radically different. The other holds that in so far as each effects a distribution of corporate surplus there is no distinction—that a distribution on final liquidation is divisible into

two parts, a return of capital investment and a distribution of surplus—and that to the extent that it effects a distribution of surplus it is to be treated as an ordinary dividend for income tax purposes.

In this brief we shall endeavor to show that the plaintiff was properly taxed, regardless of which view the court accepts, pointing out, however, that the court has heretofore adopted and applied the former view.

(b) Within the purview of the income tax law the surrender of his shares by a holder of corporate stock and the receipt by him in exchange therefor of his proportionate part of its assets by way of final distribution and liquidation is a sale or exchange of capital assets—a sale of his old shares to the corporation for cash, if the distribution is in cash, or an exchange of his old shares for property, if property rather than cash is distributed—and taxable accordingly.

When there was first presented to the Bureau of Internal Revenue the questions of whether or not a stockholder receives taxable income when on dissolution of the corporation he surrenders his shares and receives back his proportionate part of the corporate assets and, if so, how that income is to be treated and how its amount is to be computed, the Bureau decided that to the extent the amount distributed represented corporate surplus it was taxable to the shareholder receiving it in the same manner and on the same theory as though such surplus had been distributed in the form of an ordinary corporate dividend, the conclusion of the Bureau

being that when the thing distributed is surplus, it is in effect an ordinary dividend and to be treated as such, whether distributed in the ordinary course by a going concern or by way of final liquidation.

This view was adhered to consistently until decisions were handed down by this Court in the cases of *Lynch* v. *Turrish*, 247 U. S. 221, and *Lynch* v. *Hornby*, 247 U. S. 339, wherein the Court laid down the principle that the surrender of his shares by a holder of corporate stock and the receipt by him in exchange therefor of his proportionate part of its assets by way of final distribution and liquidation is a sale of his shares to the corporation where the distribution is made in cash, or an exchange of his shares for other property where the distribution is made in kind, and the income derived therefrom is taxable as on such a sale or exchange rather than as an ordinary dividend.

The facts in the *Turrish case* were as follows:

Prior to March 1, 1913, and continuously thereafter until the surrender of his stock as hereafter mentioned, Turrish was a stockholder in the Payette Lumber and Manufacturing Co., a corporation organized in 1903 with power to buy, hold, and sell timber lands, and which, in fact, never engaged in any other business. Immediately after its organization the company began to invest in timber lands and prior to March 1, 1913, had thus invested approximately $1,375,000. On March 1, 1913, the value of its assets was not less than $3,000,000, of which sum the

value of the timber lands was not less than $2,875,000. The increase was due to the gradual rise in the market value of the lands. At that date the value of Turrish's stock was twice its par value, or $159,950. On December 31, 1913, the Payette Company sold all of its assets for cash to another corporation, the latter paying such a purchase price that there was available for distribution to the Payette Co. stockholders twice the value of their stock. After the transaction was carried through, the Payette Company's only assets consisted of cash to the amount of double the par value of its stock and had no debts or other liabilities. The cash was distributed to the stockholders on the surrender of their certificates of stock, and the company went out of business. In this way, on the surrender of his shares, Turrish received $159,950, being double their par value. The Commissioner of Internal Revenue considered that of this sum one-half was not taxable, being the liquidation of the par value of Turrish's stock—a return to him of his capital investment—but that the other half was income for 1914 and taxable under the Act of 1913. A surtax was therefore collected from Turrish on that basis, which he sued to recover. This Court sustained the judgment of the District Court allowing the plaintiff a recovery. The decision is based upon three grounds: First, that the increase in the value of the lands occurred prior to the adoption of the Sixteenth Amendment and the enactment of the Income Tax Law, and, having had its status

as capital fixed prior to that time, was not taxable as income under the Act then in force; second, that the distribution received by Turrish was not an ordinary corporate dividend but a single and final dividend in liquidation of the entire assets of the company, a return to him of the value of his stock on the surrender of his entire interest in the company; and, third, that increase in value of capital assets, although realized by sale, is not income.

In the case of *Lynch* v. *Hornby*, 247 U. S. 339, decided at the same time as the *Turrish case*, the Supreme Court held that earnings of a corporation, although representing an increase in the value of its capital assets realized by sale, all of which increase had occurred prior to the adoption of the Sixteenth Amendment and the enactment of the Income Tax Law, was taxable in the hands of the stockholder, if distributed as an ordinary dividend in the usual course of business.

The fact that in *Lynch* v. *Hornby* a corporate profit representing increase in the value of capital assets occurring *prior to the adoption of the Amendment and the enactment of the Law* was held by this Court to be taxable income when distributed as an ordinary dividend, and in *Lynch* v. *Turrish* such a profit was held not to be taxable income when distributed upon the final liquidation, shows conclusively that the Court considered there is a difference between the two modes of distribution.

In discussing this point Mr. Justice Pitney, speaking for the Court in *Lynch* v. *Hornby*, 247 U. S. 339, 341, said:

> " * * * In our opinion it (the *Hornby case*) is distinguishable from the *Turrish Case*, where the distribution in question was a single and final dividend received by Turrish from the Peyette Company in liquidation of the entire assets and business of the company and a return to him of the value of his stock upon the surrender of his entire interest in the company *at a price that represented its intrinsic value at and before March 1, 1913, when the Income Tax Act took effect.*"

The opinion continues (p. 344):

> "Hence we construe the provision of the act that 'the net income of a taxable person shall include gains, profits, and income derived from * * * interest, rent, dividends, * * * or gains or profits and income derived from any source whatever' as including (for the purposes of the additional tax) all dividends declared and paid in the ordinary course of business by a corporation to its stockholders after the taking effect of the act (March 1, 1913), whether from current earnings, or from the accumulated surplus made up of past earnings or increase in value of corporate assets, notwithstanding it accured to the corporation in whole or in part prior to March 1, 1913. In short, the word 'dividends' was employed in the act as descriptive of one kind of gain to the individual stockholder; dividends being treated as the tangible and

> recurrent returns upon his stock, analogous to the interest and rent received upon other forms of invested capital."

Mr. Justice McKenna, speaking for the Court in the case of *Lynch* v. *Turrish*, 247 U. S. 221, at page 226, said:

> "The District Court and the Circuit Court of Appeals decided that the amount so distributed to Turrish was not income within the meaning of the statute, basing the decision on two propositions, as expressed in the opinion of the Circuit Court of Appeals, by Sanborn, Circuit Judge—(a) The amount was the realization of an investment made some years before, representing its gradual increase during those years, *and which reached its height before the effective date of the law, that is, before March 1, 1913*, and the mere change of form of the property 'as from real to personal property, or from stock to cash' was not income to its holders because the value of the property was the same after as before the change; (b) the timber lands were the property, capital and capital assets of their legal and equitable owner and the enhancement of their value during a series of years 'prior to the effective date of an income tax law, although divided or distributed by dividend or otherwise subsequent to that date, does not become income, gains, or profits taxable under such an act.' "

By way of answer to the first proposition, the opinion continues (page 229):

> "* * * If increase in value of the lands was income, it had its particular time and

> such time must have been within the time of the law to be subject to the law, that is, *it must have been after March 1, 1913.* But, according to the fact admitted, there was no increase after that date and therefore no increase subject to the law. There was continuity of value, not gain or increase. In the first proposition of the Court of Appeals we, therefore, concur."

With respect to the second proposition, the Court, after noting the fact that the Government relied upon the case of *Gray* v. *Darlington*, 15 Wall. 63, in answer to the Government's contention, said (p. 230):

> "* * * Besides, the contention of the Government does not reach the principle of *Gray* v. *Darlington*, which is that the gradual advance in the value of property during a series of years in no just sense can be ascribed to a particular year, not therefore as 'arising or accruing,' to meet the challenge of the words, in the last one of the years, as the Government contends, and taxable as income for that year or when turned into cash. Indeed, the case decides that such advance in value is not income at all, but merely increase of capital and not subject to a tax as income.
>
> "We concur, therefore, in the second proposition of the Circuit Court of Appeals as well as in the first and affirm the judgment."

The Court in the *Turrish case* was dealing solely and specifically with the nature of a corporate distribution on final liquidation and the taxability to the stockholder of the thing distributed. Hence we

are unquestionably correct when we say that the Court held in that case, in principle, that the surrender of his shares by a stockholder in a corporation in exchange for his proportionate part of the corporate assets by way of final liquidation is a sale or exchange of capital assets.

The proposition that increase in value of capital assets realized by sale might not be income, was abandoned by the Court and a contrary rule laid down in the cases of

Merchants Loan and Trust Co. v. *Smietanka*, 255 U. S. 509;

Goodrich v. *Edwards*, 255 U. S. 527;

Walsh v. *Brewster*, 255 U. S. 536;

Eldorado Coal and Mining Co. v. *Mager*, 255 U. S. 522.

The cases of *Lynch* v. *Turrish* and *Lynch* v. *Hornby* were decided by this Court and opinions handed down on June 3, 1918. On June 13, 1918, the Solicitor of Internal Revenue rendered an opinion in accord with the Court's view of the nature of a final distribution, which was adopted for the guidance of the Bureau, and in the administration of the Revenue Acts of 1913, 1916, 1917, and 1918 has been consistently followed ever since, having been incorporated in Regulations No. 45 (the Regulations construing the Revenue Act of 1918) as Article 1548 and subsequent Treasury decisions.

All of the Income Tax Acts from the Act of October 3, 1913, down to and including the Revenue Act of 1918, provide that ordinary corporate divi-

dends shall be subject to the surtax but not to the normal tax. The practical effect of discarding the theory that distribution of corporate surplus by way of liquidation is to be treated as an ordinary dividend and the adoption of this Court's theory as laid down in *Lynch* v. *Turrish* and *Lynch* v. *Hornby* has been twofold:

First, the Bureau has collected both the normal and the surtax on such distributions.

Second, consistent with the theory of a sale, a taxpayer has been taxed not on the whole amount of surplus distributed (as would be proper if the distribution were treated as an ordinary dividend), but on the excess of the value of the total amount distributed to him, whether in cash or property, over the cost to him of his shares in the dissolving corporation. Likewise, where his shares in the dissolving company cost him more than he received on final liquidation the difference has been allowed to him as a loss, and this regardless of the fact that part of the assets distributed to him represented corporate surplus. In view of the hopeless confusion from an administrative standpoint which would result from so doing, it is not believed that the court will reverse itself on this point at this late date.

c. The exchange of one capital asset by its owner for another of greater value at the time of such exchange than the consideration originally paid for the first asset results in taxable income to the owner to

the extent that the value of the second asset at the time of the exchange exceeds the cost of the first.

This court has recently held specifically that the sale of a capital asset for cash results in taxable income to the seller to the extent that the sale price exceeds the original cost of the asset.

Merchants Loan and Trust Co. v. *Smietanka*, 255 U. S. 509;

Goodrich v. *Edwards*, 255 U. S. 527;

Walsh v. *Brewster*, 255 U. S. 536;

Eldorado Coal and Mining Co., v. *Mager*, 255 U. S. 522.

It follows logically from this that the exchange of one capital asset by its owner for another of greater value at the time of such exchange than the consideration originally paid for the first asset results in taxable income to the owner to the extent that the value of the second asset at the time of the exchange exceeds the cost of the first. A mere increase in value of capital assets is not taxable as income prior to a sale or exchange. In order to make it taxable, the increase must be realized upon. The exchange of the capital asset for other property known to be of greater value than the original consideration paid for the first asset is as much a realization of the increased value as a sale of the same asset for cash. In both cases the owner has translated the added value of the old into other property of a value known to represent and include the increase. This prin-

ciple was recognized by this court in the case of *Eisner* v. *Macomber*, 252 U. S. 189, 207, where it said:

> "'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale *or conversion of capital assets*, * * *." (Italics ours.)

In the case at bar the plaintiff exchanged his shares in the Farmers Petroleum Co. for his proportionate part of the bonds of the American Petroleum Co. and the Republic Production Co., and the stock of the American Republics Corporation, the holding company. He paid for his shares in the Farmers Petroleum Co. $26,640. The total value of the stocks and bonds received by him upon the dissolution at the time he received them was $1,598,400. He was properly taxed, therefore, upon the difference between these two sums—$1,571,760.

Manifestly, if a corporate distribution by way of final liquidation is to be treated as a sale or exchange of capital assets, the result of such a distribution is taxable income to the stockholder wherever the value of the thing distributed exceeds the cost of the shares surrendered. And this is as true of the distribution made in the case at bar as of a distribution in cash or physical assets.

In the brief of the plaintiff in error the case of *Silversmiths Company* v. *Reed and Barton Corporation*, 199 Mass. 371, 85 N. E. 433, is cited as holding that a transaction such as the one in question does

not constitute a sale or exchange. The facts in that case were as follows:

A by-law of the Reed and Barton Corporation provided that its stockholders should not sell their stock without first offering it to the corporation. A certain amount of the stock was held by the Silversmiths Company which consolidated with another corporation under an agreement which provided that on consummation of the consolidation the stock assets of each corporation should vest in the new corporation. The question was whether the transmission of the title to the stock to the new single corporation was a "sale." The Court held that the transaction was not within the meaning of the word "sale" as used in the by-law. The case, therefore, is clearly distinguishable from the case at bar and, furthermore, the decision *obiter*, that the transaction did not constitute a barter or exchange, is overruled by the very recent case of *Osborne* v. *Tax Commissioner*, 236 Mass. 88, 126 N. E. 371.

As we have stated above, if there is any distinction between the *Phellis case* and the case at bar growing out of the form of distribution, it must be based on the theory that, while in both cases there has been a gain to the stockholder, the gain to him in the case of final distribution respresents a gain accruing to capital which has not been severed from his capital investment or received by him for his separate use, benefit, and disposal. Viewing the liquidation in the case at bar as a sale or exchange, the fact of

realization—the severance of the gain from capital—is easily demonstrated. The stockholder's capital is his share of stock. What he pays for his stock ceases to be his individual property and becomes a part of, and loses its identity in, the general property of the corporation. What he has after purchase is simply a stockholder's right to have all the assets of the corporation devoted to the corporate business, to receive his proportionate share of any dividends declared, and to receive back on dissolution his proportionate part of the corporate assets, whatever they may be. So long as his investment remains in the corporation, no part of the accretion thereto is subject to his separate use, benefit, or disposal, unless made so by ordinary dividend; but the moment final dissolution takes place he has cash or specific property representing his gain, which he may use or dispose of as he sees fit. That his portion of the liquidating dividend representing both his capital invested and his gain happens to be all in the same kind of property, is immaterial.

In *United States* v. *Phellis*, *supra*, there was said to have been a severance or realization because after the payment of the dividend the stockholder, Phellis, could sell or otherwise dispose of the stock received thereby without in any way affecting his capital investment in the old corporation. In the case at bar it is equally true that after the final distribution the stockholder, Cullinan, could have sold or disposed of that part of the stocks and bonds of the new companies which represented his gain, and at the same

time have retained such part as represented his original investment or capital. He had 266.4 shares of stock in the Farmers Petroleum Co. purchased for cash at par ($100), a total investment of $26,640. Upon dissolution he received 799.2 shares of stock in the American Republics Corporation of the par value of $100, and bonds of the two new Texas companies aggregating $799,200 in value. He had only to set aside such a part of the new stocks or bonds, or both, as would cover his cost or capital investment ($26,640) and sell or otherwise dispose of the balance at his pleasure. The severance of gain from capital and its realization by the stockholder was in every respect as complete in this case as in the *Phellis* and *Rockefeller cases*. In this connection it must be borne in mind that this is a sale or exchange of his shares; that no question arises as to whether he is retaining his same proportionate interest in the corporation or in the assets of the corporation. As to him, the old corporation has been dissolved; he is getting out of it; his capital was his shares in the old corporation; that he has disposed of. He is now getting in exchange, not only stock of another corporation, but also the promises of two more corporations to pay *cash*, with security.

That the plaintiff realized taxable income at least to the extent that the value of the bonds received exceeded the cost of his original shares in the Farmers Petroleum Co., is entirely clear. After the final distribution the plaintiff could have sold or disposed of any part or all of the bonds of the new companies

and at the same time have retained his entire investment in the enterprise. There was a complete severance of this much of his profits from his capital investment. Upon the receipt of the bonds so much of his investment in the enterprise as a stockholder has been completely withdrawn and liquidated. To that extent he is no longer a stockholder in any sense but a secured creditor of the two new Texas corporations. To that degree he has substituted his proprietary relationship for that of mortgages. He has taken out an amount of cash, or cash's equivalent, equal to the face value of the bonds. Regardless of anything that may subsequently happen to this stock in the holding company, this profit represented by the bonds can never be affected. The stock was fully paid and hence could never become a liability and thereby reduce his profit. If the stock should become worthless, the amount of the profit included in the bonds would not be reduced.

His original investment was $26,640. The actual, as well as the par or face value of the bonds received by him, is conceded to be $799,200. Regardless, therefore, of what view may be taken of the case with respect to the stocks, income was received by him at least to the extent of the difference between the value of the bonds and the cost of his shares in the old corporation—$772,800.

d. Regarding a distribution on final liquidation as in effect an ordinary dividend, in so far as it represents a distribution of surplus, the plaintiff was properly taxed.

If we are to regard the transaction in the case at bar as in substance an ordinary dividend, then to the extent that it effected a distribution of surplus the case is identical with *United States* v. *Phellis, supra*, and *Rockefeller* v. *United States*. In each case the thing taxed is the profits or fruits of stock ownership. Certainly, the mere fortuitous circumstance that in the *Phellis* and *Rockefeller cases* the surplus was distributed as a dividend in the ordinary course by a corporation that continued its separate existence thereafter in the further pursuit of profits, while in the case at bar there was a final distribution and dissolution of the corporation, should not determine the question of the taxability. If such a distinction is proper, then, carried to its logical conclusion, we have this condition: An individual or group of individuals wishing to escape taxation on his or their income from a business enterprise need only incorporate it, proceed to carry on business in corporate form, accumulating their profits until such time as they are ready to discontinue the business, then dissolve and distribute the profits all at one time. Or, to take another illustration, an individual owns a tract of land which he believes will increase in value. He has only to form a corporation, transfer the land to the corporation in exchange for its stock, allow the corporation to hold the land until he is ready to sell, then have the corporation sell it, dissolve and distribute the proceeds, both original investment and profit, to him, tax-free. In each example, by the simple expedient of accumulating the profits until

time for distribution, instead of distributing them as they accumulate, the stockholder has escaped the tax. Unquestionably, the thing distributed is exactly the same, regardless of the mode of distribution. Under the decided cases it is taxable income if distributed as an ordinary dividend.

Lynch v. *Hornby*, 247 U. S. 339;
Peabody v. *Eisner*, 247 U. S. 347;
U. S. v. *Phellis*, 257 U. S. 156;
Rockefeller v. *U. S.*, 257 U. S. 176.

No logical reason exists for treating it otherwise when distributing it on final liquidation.

The present case presents a very good illustration of the absurdity of holding all corporate distributions by way of liquidation, although including not only capital but surplus as well, exempt from taxation because distributed in that manner rather than as an ordinary dividend. The Farmers Petroleum Co. had at the time of its dissolution an accumulated operating surplus of $1,343,105.95, which, so far as the records show, was all in cash. Suppose, instead of carrying through its reorganization in the way it did, it had dissolved and distributed the whole of its assets in kind. In that event the appellant would have received back his capital investment and in addition his proportionate part of the earned surplus. By the mere accident of his having received it upon dissolution he would have escaped tax thereon, whereas, if the day before dissolution was determined upon, the corporation had distributed the same surplus to him and the other stockholders

as an ordinary dividend, he would have been subject to tax. Or, suppose again the old company had carried through the reorganization in the exact manner actually employed, except that instead of dissolving, it had retained enough of the bonds to cover its outstanding capital stock and had distributed the remainder of the bonds and all the stock of the holding company, as any ordinary dividend. In that event the case would fall squarely within the *Phellis* decision.

It will be recalled that the Farmers Petroleum Co., or its trustees in liquidation, transferred all of its assets to the two new Texas companies in exchange for their stocks and bonds. Included in these assets was not only the $1,343,105.95, operating surplus, but also its oil properties, pipe lines, and other capital assets. It may possibly be argued by the appellant that if he is taxable at all, it is only to the extent that the distribution to him consisted of his proportionate part of this operating surplus. The answer to this question is not difficult. From the standpoint of the stockholder all of the corporation's assets in excess of the amount paid in for its capital stock is surplus, regardless of whether such assets represent earned surplus (that is, earnings from normal business operations) or a mere increase in value of its assets. They were so treated in *United States* v. *Phellis*, and *Rockefeller* v. *United States*. As to a stockholder, no particular assets of the corporation can be pointed out and earmarked as capital or surplus. His capital in-

vestment is what he puts into the corporation—the cost of his shares. What he receives back on dissolution in excess of what he puts in is surplus.

What is said above with respect to the question of realization or severance of income from capital, in discussing the effect of the transaction when viewed as a sale or exchange, is equally applicable in principle, if it is treated as in effect an ordinary dividend. The stockholder's capital or capital investment is the amount he and prior owners of the same stock have contributed to the capital of the corporation. After dissolution plaintiff could have sold or disposed of that part of the stock and bonds of the new companies which represented his gain, and at the same time have retained such part as represented his investment or capital. His investment was $26,640. Upon dissolution he received stock of the holding company of the value of $799,200 and bonds aggregating $799,200 in value. He could retain such part of the new stock or bonds, or both, as would cover his capital investment and sell or otherwise dispose of the balance as he might see fit. All in excess of his investment is realized profit reduced to possession and severed from capital, and taxable as income.

Here, again, the character of the bonds as income is unquestionable. After the dissolution the plaintiff could have sold or disposed of any part or all of the bonds without affecting his investment or proprietary interest in the enterprise. The severance

of this much of his profit from his capital investment was complete. To the extent of their value he has withdrawn surplus from the corporation—he has substituted the relationship of secured creditor for that of stockholder. Nothing that may happen to the stock in the holding company will reduce this profit.. Being fully paid up, it can never become a liability and hence can never reduce his profit, and if it should become worthless, the amount of the profit realized through the receipt of the bonds would not be reduced.

e. From the standpoint of the stockholder, the effect of the transaction was more than a mere reorganization of the same enterprise.

It may be contended that the effect of the so-called reorganization of the business of the Farmers Petroleum Co. was not to sever any part of the profits of the enterprise but to fix their status even more firmly as capital; that, looked at as a whole, the purpose and effect of the transaction was to continue the business without a distribution to the stockholders of any part of the property, surplus, or otherwise. This is but another way of saying that looking at the substance of the transaction, the plaintiff realized no income because after the transaction took place he had nothing he did not have before; that he had merely exchanged one set of certificates for another; that his new stock and bonds were but different evidences of his ownership of the same assets or enterprise.

This argument, we wish to point out, involves a total disregard of the intervening corporate entities. It was pressed upon the Court with great earnestness and discussed exhaustively in the cases of

Eisner v. *Macomber*, 252 U. S. 189;
United States v. *Phellis*, 257 U. S. 156;
Rockefeller v. *United States*, 257 U. S. 176;

and discarded by the Court as unsound, and properly so.

See also:

Blalock v. *Ga., etc., Co.*, 246 Fed. 387;
Rensselaer, etc., Co. v. *Irwin*, 249 Fed. 726; writ of certiorari denied 246 U. S. 671;
West End St. Ry. Co. v. *Malley*, 246 Fed. 625; writ of certiorari denied 246 U. S. 671;
Waclark Realty Co. v. *Williams, Comptroller*, 198 N. Y. 54; 91 N. E. 266.
Walker v. *Gulf and Interstate R. R. Co.*, 269 Fed. 885;
Butterick Co. v. *U. S.*, 240 Fed. 539;
U. S. v. *Nipissing Mines Co.*, 206 Fed. 431;
Houston Belt and Terminal Railway Co. v. *U. S.* 250 Fed. 1;
In re: *Watertown Paper Co.*, 169 Fed. 252;
Atchison, etc., Co. v. *Weeks*, 248 Fed. 970;
Pullman Co. v. *Mo. Pac., etc., Co.*, 115 U. S. 587;
White v. *Pecos Land and Water Co.*, 18 Tex. Civ. App. 634; 45 S. W. 207;
Peterson v. *Chicago, etc., Co.*, 205 U. S. 364.

Both corporate stocks and bonds are property in and of themselves separate and apart from the corporation which issues them. *Deganey* v. *Lederer*,

250 U. S. 376. The new stocks were not mere certificates or evidences of ownership of the same assets. The new corporation had separate and different franchises and charters from the old with different powers, each with an actual or potential good will of its own due to its corporate name, powers, etc., and with a larger capital stock liability. Physical assets do not make a corporation. It takes a charter, a corporate name, stockholders, directors and much else. Nor do mere physical assets give corporate stock all its value. Its position in the business in which it is engaged, its corporate powers, its record for paying dividends, the character and ability of the men who control it—all of these add to or diminish the value of its stock.

Again, the new stock in the holding company was not merely new evidence of ownership of the same assets. It did not represent the same control over them. The direct management of the new enterprise was in the control of the holding company. The immediate authority in the direction of the business of the operating companies was vested in the stockholder or stockholders and the directors of the operating company. His proportionate interest in the enterprise would at any time be changed if the holding company should dispose of any of its stock in either operating company. Without his consent and against his will, the holding company might at any time dispose of a part or all of its stock in either or both of the operating companies. So long as the

old corporation existed a minority stockholder had a voice in the management of the entire business, both producing and pipe line, which would not be taken from him so long as he retained his stock. Likewise, his proportionate interest in the business could not be changed without his having a voice in the matter. As a stockholder in the holding company, however, he had no such voice in the control of the business and his proportionate interest in the enterprise might be changed at any time without any action on his part or even against his will. As a stockholder in the old company his voice in the management of the business was direct, his influence immediate. As a shareholder in the holding company his voice was indirect and remote.

Considered solely from the standpoint of value, the assets of the enterprise were much more valuable in the hands of the new corporations because the latter could carry on legally the two kinds of business which the old could not, and because they were not hampered in securing credit by their small capitalization, as the old one was.

Consider the matter from the standpoint of the bonds. The case as to them is, if possible, stronger than as to the stocks. The plaintiff had exchanged stock in one corporation for bonds in two others as well as stock in a third. The difference between corporate stocks and bonds is fundamental. Stocks represent ownership of the corporation. Bonds are its promissory notes—its debts. Stockholders are not entitled to dividends which will impair capital,

nor to return of their capital on dissolution until all debts are paid. Bondholders must be paid their principal and interest when they fall due, if it takes all the assets of the corporation, both capital and surplus.

Once to commence disregarding the separate identity of stockholder and corporation would result in hopeless confusion in the interpretation of the income tax laws, as there would be no logical point at which to stop short of a complete disregard. In this connection permit us to call the Court's attention to the following language in the case of *Eisner* v. *Macomber, supra:*

> "* * * We must treat the corporation as a substantial entity separate from the stockholder, not only because such is the practical fact but because it is only by recognizing such separateness that any dividend—even one paid in money or property—can be regarded as income of the stockholder. Did we regard corporation and stockholders as altogether identical, there would be no income except as the corporation acquired it; and while this would be taxable against the corporation as income under appropriate provisions of law, the individual stockholders could not be separately and additionally taxed with respect to their several shares even when divided, since if there were entire identity between them and the company they could not be regarded as receiving anything from it, any more than if one's money were to be removed from one pocket to another." 252 U. S. 189, 213.

Certainly, the Court will not so far disregard the corporate entities as to say that because these bondholders owned all the stock in the corporation they merely held evidences of a debt due to themselves from themselves. While this last statement appears to be *reductio ad absurdum*, yet it states exactly the effect of disregarding the corporate entities.

In the brief of the plaintiff in error, much space is devoted to a review of the various changes in subsequent statutes partially or wholly exempting the income from such transactions as the one in the case at bar from the income tax, and to a discussion of the various regulations of the Bureau construing those Acts. This discussion, however, is wholly irrelevant. No question of statutory interpretation is involved in the case. As we have said above, the Act of 1916 (the Act under which the tax in the case at bar was collected) specifically taxes all income, from whatever source derived. The sole question is: Did the transactions result in income? It is strictly a constitutional question, in the decision of which the interpretation of such statutes is in no way helpful.

CONCLUSION.

Preserve the separate identity of stockholder and corporation and of the various corporations, old and new, as among themselves, and give these separate corporate entities their proper force and effect and the case at bar is ruled either by

Merchants Loan and Trust Co. v. *Simetanka*, 255 U. S. 509;

Goodrich v. *Edwards*, 255 U. S. 527;
Eldorado Coal and Mining Co. v. *Mager*, 255 U. S. 522;
Walsh v. *Brewster*, 255 U. S. 536;

or by

United States v. *Phellis*, 257 U. S. 156;
Rockefeller v. *United States*, 257 U. S. 176;
Peabody v. *Eisner*, 247 U. S. 347;
Lynch v. *Hornby*, 247 U. S. 339;

depending upon which view the Court takes of the nature of a distribution by way of final liquidation. If such a distribution is to be regarded as in the nature of a sale, it is governed by the first group of cases. If it is treated as an ordinary dividend to the extent that it affects a distribution of surplus, it is ruled by the latter group.

It is therefore submitted that whichever view the Court adopts, the judgment of the lower court is right and should be affirmed.

JAMES M. BECK,
Solicitor General of the United States.
NELSON T. HARTSON,
Solicitor of Internal Revenue.
P. C. ALEXANDER,
Special Attorney, Bureau of Internal Revenue.
PCA/LM

IN THE

Supreme Court of the United States

OCTOBER TERM, 1926.

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The judgment and opinion in this case may affect the question of whether or not there is taxable gain where a new corporation has been organized to take over the assets of an existing corporation and stockholders have received in exchange for every old share several new shares of the same par value as the old and of a market value greater than the cost of the old shares.

ARGUMENT 3

a. Taxable gain does not arise from what is *in form* a dividend, an exchange or a sale, unless it is *in substance* also a dividend, an exchange or a sale.

b. Taxable gain does not arise where a stockholder has received additional stock whether in the form of a stock dividend or in the form of stock in a new company organized to take over the assets of the old unless

1. such additional stock represents part of the assets of the old corporation separated from the common fund;

2. it has been severed from the property;

3. it can be sold by the stockholder to obtain money to pay any income tax assessed on the transaction without altering his pre-existing proportionate interest in the capital of the corporation;

4. nor if after the stockholder has received it, the original investment of all the stockholders together with accretions and accumulations still remain subject to business risks which may wipe out the entire investment..... 4

c. Until after *Eisner* v. *Macomber*, 252 U. S. 189, the Income Tax Bureau treated the additional shares received in a reorganization as a stock dividend... 14

d. Its failure to continue to do so has resulted in contradictory and confusing rulings..... 20

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e. A rule for determining whether or not taxable income has been received is this: Find out whether or not what has been done could have been done in another way which admittedly would not have produced taxable income. If it could the product is not taxable income. The product is a substance and that is identical. The methods are the forms and they are different

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IN THE

Supreme Court of the United States,

OCTOBER TERM, 1922.

J. S. CULLINAN,
Plaintiff in Error,

AGAINST

A. S. WALKER, as Collector of Internal Revenue for the First District of Texas,
Defendant in Error.

Brief submitted with the consent of Court by James Byrne, Amicus Curiæ.

Statement.

There are many cases which sooner or later will be before this Court which may be affected not only by the judgment in this case but by the language of the opinion. Such are cases where a new corporation has been organized to take over the assets and liabilities of an existing corporation, and in exchange for their shares the stockholders of the old corporation have received shares of the new corporation of a par value greater than that of their shares of the old corporation and of a market value in the aggregate greater than the cost of their old shares.

The Circuit Court of Appeals for the 6th Circuit has recently held in *Weiss* v. *Stearn,* reported in the Federal Income Tax Service, 1923, Paragraphs 3158-3165 that under the Income Tax Law of 1916 no taxable gain results from such an exchange. See also *Alpha Portland Cement Company* v. *U. S.,* 261 Fed. 339, 257 Fed. 432. The Income Tax Bureau holds that in such cases taxable gain does result both under the law of 1913 and the law of 1916, and that, where under either of these laws the holder of a share of the old corporation of the par value of $100, for which he paid $150, has exchanged it for five shares of the new corporation of the par value of $100 a share and of a total aggregate market value of $550, the stockholder has made a taxable gain of $400.

We maintain that the Circuit Court of Appeals is right and the Income Tax Bureau is wrong. The decision of the Court on this point is of very great importance, because, we submit, the Income Tax Bureau has refused to follow the principles and the reasoning of the Court in *Eisner* v. *Macomber,* 252 U. S. 189; *Phellis* v. *U. S.,* 257 U. S. 156; *Rockefeller* v. *U. S.,* 257 U. S. 176; and the result has been in the rulings and practice of the Bureau contradiction and confusion as we shall show under Point IV. That state of affairs can be straightened out only by a reiteration of those principles by the Court and their application to the case we are presenting.

I.

At times the Bureau disposes of the case which we are arguing by saying the old corporation and the new corporation are separate and distinct entities; and therefore a stockholder in the old corporation has simply sold his stock in one entity for stock in another and the transaction does not differ from the sale of his stock for cash. But it only says this in cases where it decides that there is taxable gain. In the cases where it holds under the laws of 1913 and 1916 that an exchange of stock in one company for stock in a reorganized company does not produce capital gain it pays no attention to its entity theory. But if the Bureau should decide tomorrow to make its practice uniform and to say that thereafter corporations whatever their relations to one another should always be regarded for income tax purposes as separate entities it would have no right to do so. For this court has decided that they are not. It said in *Southern Pacific Co.* v. *Llewellyn,* 247 U. S. 330, and *Gulf Oil Co.* v. *Llewellyn,* 248 U. S. 71, in talking about dividends and income taxes that substance must be regarded, form disregarded; that the fact that two corporation are in form separate entities does not settle the matter, does not necessarily make the one that receives the dividend from the other taxable as upon the receipt of income. The court

paid attention to the relationship between the two entities and said that there could be such a relationship as to make what was in form a dividend in substance not. On the same principle there can be such a relationship between corporations that what in form is a sale or exchange of stock in substance is not. In *Eisner* v. *Macomber,* the court held that something which in form was a dividend and which was called a dividend was not a dividend; "having regard to the very truth of the matter, to substance and not to form, he" (the stockholder) "has received nothing that answers the definition of income within the meaning of the 16th Amendment".

II.

This court said in *Eisner* v. *Macomber, Phellis* v. *U. S.,* and *Rockefeller* v. *U. S.,* that these are tests whether or not something which the stockholder has received is taxable gain:

(*a*) Is it, or does it represent, part of the assets of the corporation separated from the common fund?

(*b*) Has it been severed from the property and received by the stockholder for his separate use and disposal?

(*c*) Can it be sold by the stockholder in order to obtain money to pay any income tax assessed

on the transaction without altering his pre-existing proportionate interest in the capital of the corporation?

(*d*) After the stockholder has received it, does the original investment of all the stockholders together with accretions and accumulations still remain subject to business risks which may wipe out the entire investment?

In *Eisner* v. *Macomber,* 252 U. S. at page 210 the Court said:

> "This, however, is no more than a book adjustment, in essence, not a dividend, but rather the opposite; no part of the assets of the company is separated from that common fund, nothing distributed except paper certificates that evidence an antecedent increase in the value of the stockholder's capital interest resulting from an accumulation of profits by the company, but profits so far absorbed in the business as to render it impracticable to separate them for withdrawal and distribution. * * * This, however, is merely book-keeping that does not affect the aggregate assets of the corporation or its outstanding liabilities; it affects only the form, not the essence, of the 'liability' acknowledged by the corporation to its own shareholders, and this through a readjustment of accounts on one side of the balance sheet only, increasing 'capital stock' at the

> expense of 'surplus'; it does not alter the pre-existing proportionate interest of any stockholder or increase the intrinsic value of his holding or of the aggregate holdings of the other stockholders as they stood before. The new certificates simply increase the number of the shares, with consequent dilution of the value of each shares."

and again at page 211:

> "The essential and controlling fact is that the stockholder has received nothing out of the company's assets for his separate use and benefit; on the contrary, every dollar of his original investment, together with whatever accretions and accumulations have resulted from employment of his money and that of the other stockholders in the business of the company, still remains the property of the company, and subject to business risks which may result in wiping out the entire investment. Having regard to the very truth of the matter, to substance and not to form, he has received nothing that answers the definition of income within the meaning of the Sixteenth Amendment."

and again at page 213:

> "Brief as it is, it indicates the characteristic and distinguishing attribute of income essential for a correct solution of the present controversy * * * *not* a gain *accruing to*

> capital, not a *growth* or *increment* of value *in* the investment; but a gain, a profit, something of exchangeable value, *proceeding from* the property, *severed from* the capital however invested or employed *and coming in*, being *derived*, that is *received* or *drawn* by the recipient (the taxpayer) for his *separate* use, benefit and disposal—*that* is income derived from property. Nothing else answers the description."

All of these extracts are important; but there are certain phrases we wish particularly to call to the attention of the court. These are the description of income as something "*severed from the capital*, however invested or employed", and the words "no part of the assets of the *company is separated from the common fund*". The idea in these phrases is at the bottom of the decisions in the stock dividend case and in the *Phellis* and the *Rockefeller* cases as well.

What were the facts in the latter cases?

In the *Rockefeller* cases corporation A conveyed some of its property of a value less than its surplus to a new corporation B for stock of corporation B and divided that stock among the stockholders of corporation A as a dividend (in one of the cases the stock went directly from corporation B to the stockholders of corporation A, but the Court said it must be treated as if it had gone to corporation A and been distributed

by it). In the *Phellis* case corporation A sold all its property to a new corporation B and accepted stock of corporation B in payment. It retained in its treasury some of the stock of corporation B, paid off its indebtedness with some more of the stock of corporation B and distributed the rest of the stock of corporation B among the stockholders of corporation A as a dividend.

The court held in both the *Rockefeller* and the *Phellis* cases that the stock of corporation B received by stockholders of corporation A was taxable income.

It reasons were:

(1) part of the surplus of corporation A, which before was not under the control of any individual stockholder, came under his control when he received shares of corporation B as a dividend.

(2) immediately thereafter every stockholder had shares in two companies:

(*a*) shares in corporation A representing the same proportionate interest as before in the capital of corporation A;

(*b*) shares in corporation B representing his proportionate share in what was formerly surplus of corporation A. The shares in corporation B represent something *severed from the capital* of corporation A. They are "part of the assets of the company" "separated from that common fund". They are something which the "stockholder has re-

> ceived" out of the company's assets for his separate use, benefit and disposal. They no longer "remain the property of the company" nor are they subject to business risks which may result in wiping them out. Every stockholder may sell a portion or all of the shares received by him of corporation B and still have the same proportionate interest in corporation A as before the sale. In other words, every stockholder has the power of realizing on the surplus without giving up any of his proportionate share of the capital.

The difference between the *Phellis* and *Rockefeller* cases and the stock dividend case is that in the latter if the shareholder, who has five shares where he formerly had one, sells a single share of the five he no longer has the same proportionate interest in capital as before. He has no power of realizing on the surplus without giving up a proportionate share of the capital. *He has shares in one corporation only* and every single share represents both capital and surplus, just as every single original share represented both.

The same is true of a stockholder of a company who has exchanged his one share for five shares of a new company. If he sells a single share of stock in the new Company he alters his relative proportion of ownership, not only of surplus, but of capital. Great emphasis is laid in the *Phellis* and *Rockefeller* cases on this point.

In the *Phellis* case the court says, differentiating the case from the stock dividend case:

> "* * * he could sell his entire portion" (*i. e.*, of the stock received as a dividend), "or any of it without parting with his capital interest in the parent company or affecting his proportionate relation to the interests of other stockholders."

The stockholder who receives five shares of a new company for one of the old cannot pay an income tax on what the income tax office calls his income without selling shares which represent capital. This is the condition of things which, Mr. Justice Pitney speaking for the Court in *Eisner* v. *Macomber* 252 U. S., at pages 212 and 213 says, shows conclusively that a stock dividend is not income:

> "It is said that a stockholder may sell the new shares acquired in the stock dividend. * * * But if a shareholder sell dividend stock he necessarily disposes of a part of his capital interest, just as if he should sell a part of his old stock, either before or after the dividend. What he retains no longer entitles him to the same proportion of future dividends as before the sale. His part in the control of the company likewise is diminished. * * * Yet, without selling, the shareholder, unless possessed of other resources, has not the wherewithal to pay an income tax upon the dividend stock. Nothing

could more clearly show that to tax a stock dividend is to tax a capital increase, and not income, than this demonstration that in the nature of things it requires conversion of capital in order to pay the tax."

Another difference is that in the *Phellis* and *Rockefeller* cases, the shares of corporation B distributed to the stockholders of corporation A were *severed from the capital of A,* while in the stock dividend and the reorganization cases the new shares received did not represent anything severed from capital.

"* * * The inquiry must be", says the court in the *Phellis* case, "whether the shares of stock in the new company received by claimant as a dividend by reason of his ownership of stock in the old company, constituted, to apply the tests laid down in *Eisner* v. *Macomber,* 252 U. S. 189-207, a gain derived from capital. * * * a profit, something of exchangeable value, proceeding from the property *severed from the capital however invested.*"

"But when this common stock was distributed among the common stockholders of the old company as a dividend then at once * * * the individual stockholders of the old company * * * received assets of exchangeable and actual value *severed from their capital interest in the old company.*"

"It thus appears that in substance and fact, as well as in appearance, the dividend

> received by claimant was a gain and profit derived from his capital interest in the old company, not in liquidation of the capital, but in distribution of accumulated profits of the company; *something of exchangeable value produced by and proceeding from his investment thereof severed from it and drawn by him for his separate use.*"

In the *Rockefeller* and *Phellis* cases the capital remains in corporation A. The shares of corporation B received as dividends by the stockholders of corporation A are part of what once was surplus of A "severed from the capital"; consequently the shareholders of A in the *Phellis* and *Rockefeller* cases can dispose of their shares of stock B and retain the same proportionate interest in A that they had always had. But in the stock dividend case and a reorganization case nothing is "severed from the capital". In both cases every share of the new stock represents a share of capital and surplus both. Consequently the shareholders can not dispose of a share and retain the same proportionate interest they had formerly had in the capital.

On page 4 we said this court had given four tests of whether or not something which a stockholder has received is taxable gain. Apply these tests to any one of the five shares which in exchange for his one share a stockholder has re-

ceived from the new company organized to take over the assets of the old company:

1. Is it, or does it represent, part of the assets of the corporation separated from the common fund?

No. Therefore it is not taxable gain.

2. Has it been severed from the property of the corporation and given to the stockholder for his separate use and disposal?

No. Therefore it is not taxable gain.

3. Can it, or any part of it, be sold by the stockholder in order to obtain money to pay any income tax assessed on the transaction without altering his pre-existing proportionate interest in the capital of the corporation?

No. Therefore it is not taxable gain.

(4) After the stockholder has received it, does the original investment of all the stockholders together with accretions and accumulations still remain subject to business risks which may wipe out the entire investment?

Yes. Therefore, it is not taxable gain.

The answers to the tests are the same as if the stockholder had received a stock dividend.

Why then should the stockholder be taxed in the one case and not in the other? Nothing is

escaping taxation. When the stockholder actually sells his stock in either case he makes his gain and pays his tax. The government does not lose; because the rate of taxation when reorganizations were made in 1913 to 1916 inclusive was low, but when the stock was sold in 1917, 1918, 1919 and 1920 the rate was very high. The fair thing is to tax a man on the profit he really makes and that is never known till he really sells. There is of course no real sale in the minds of any one when he merely changes the evidence of his interest in certain assets. There can be no real sale unless to another person. But there is no other person in a reorganization. The same persons—the stockholders—are dealing with themselves. In Massachusetts the Court has held in *Osgood* v. *Tax Commissioners,* 235 Mass. 88, that a reorganization is a sale, but on purely technical grounds. It has also held stock dividends and the amount received from the sale of rights to subscribe for stock are income *Tax Commissioners* v. *Putnam,* 227 Mass. 522.

III.

We have said the answers to the tests of page 4 are the same as in the case of a stock dividend. And they are the same because in substance the additional shares received in a reorganization *are* a stock dividend.

The rulings and the practice of the Bureau was for years to treat them so; not as analogous to a stock dividend but *as* a stock dividend and to call them a stock dividend.

At the beginning the Bureau held that the exchange of shares of stock in a company for shares of a new company, formed for the purpose of taking over the assets of the old company, did not produce taxable income. But later, Treasury Decision 2274 was made: "stock dividends paid from the net earnings or the established surplus or undivided profits of corporations, joint stock companies or associations or insurance companies, are held to be the equivalent of cash and to constitute taxable income under the same conditions as cash dividends", and the 1916 law declared stock dividends taxable.

The income tax office considered that this decision and statute modified its previous rulings that several shares of stock of the new company issued in exchange for one share of the old company did not constitute taxable gain. This is shown by the letter of March 8, 1917, to the Corporation Trust Company, I. T. S. 1918, Par. 1301. The case put to the income tax office was this: A corporation with an authorized capital stock of $750,000 in 1910 acquired property in exchange for its total issued capital stock, $525,000. It proposed to incorporate a new company with the same author-

ized capital stock and the same issued capital stock, with the intention of having the new company acquire the assets of the old and of having the stockholders of the old company receive in place of each share of stock in the old company a share of stock in the new company. The property owned by the old company had increased in value from 1910 so that the shares of the old company were worth "double par". The Bureau said that "the transaction resulted in no gains, profits or income to either the first corporation or to its stockholders". "The exchange of stock, that is the issuance of stock by the second corporation for the stock of the first corporation, share for share of like par value, *would not constitute a stock dividend,* but an exchange on the basis indicated with no result in any taxable income to the stockholders of the first company receiving in exchange for their former holdings the stock of the second company."

This language makes it perfectly clear that up to this time the so-called entity theory did not exist. The Bureau says: "If, as you say, the stock of the first company at the time of this transaction was worth 'double par', the stock of the second company being supported by identically the same assets is presumably of the same value, and the exchange of the new stock for the old results in no income subject to tax." The theory of the Bureau up to this time was that the

mere change from stock of one corporation to stock of another, where the assets were the same, produced no gain except as treasury decision 2274 and the law of 1916 about stock dividends required the Bureau to rule that there was a gain. The Bureau considered that this treasury decision and the law of 1916—that if a stockholder exchanges one share of his stock in corporation A for five shares of stock in corporation A, the additional four shares were taxable gain—were decisions that if he exchanged one share of corporation A for five shares of corporation B, a new corporation organized to take over the assets of corporation A, the additional four shares of corporation B were taxable gain because the Bureau considered corporation B though a new form of corporation A the same in substance. In other words, where the exchange is made share for share, whether for stock of Company A or stock of company B, which is to have the same assets as company A, there is no gain. But as under T. D. 2274 and the law of 1916 if a man for one share of company A receives five shares of company A, as in the case of the stock dividend, there is taxable gain to the extent of the value of four new shares, so if he exchanges one share of company A for five shares of company B which is to acquire the assets of company A there is taxable gain to the extent of the value of the four new shares. It is clear from the reading of the pub-

lished records of the income tax office that the reason why a distinction was made between the case where one share in an old company is exchanged for one share in a successor company and a case where one share is exchanged for several shares has nothing to do with theories about entities but is based solely on the treasury decision declaring stock dividends taxable. In fact the Bureau says so in so many words in its letter of March 8, 1917; it says that, where only one share of the new company is received for one share of the old, the share of new stock does not "constitute a stock dividend", showing clearly that the Bureau considered that if five shares of the new company were received for one share of the old, four of the shares of the new *would* "constitute a stock dividend". To the Bureau, as we have said, the new additional shares of the new company were not analogous to a stock dividend but *were* a stock dividend—and they were a stock dividend though not shares of the old company because the new company was in substance the old company; for the additional shares, whether of the old company or of the new, were merely additional pieces of paper representing with the other share the same interest in the same assets.

So far then we have

(*a*) a period when the Bureau held taxable gain did not arise from a stock dividend or from a reorganization;

(*b*) a period when it held taxable gain did arise from a stock dividend and held as a consequence that taxable gain did arise from a reorganization.

Then came *Towne* v. *Eisner,* 245 U. S. 418 (January 7, 1918), and *Eisner* v. *Macomber* (March 8, 1920), and in consequence

(*c*) a period when the Bureau held that no taxable gain arises from a stock dividend. To be logical and consistent the Bureau in period (*c*) should have held and should now hold that no taxable gain arises from a reorganization. This the Bureau in some cases does and in others does not. It has been, and is, illogical and inconsistent. It makes a distinction between a case where the exchange is share for share and where the exchange is one share for several shares; and when it writes an opinion giving any reasons for the distinction it always says something in conflict with the reasoning in *Eisner* v. *Macomber;* and it does so because it is impossible not to do so. Thus in A. R. R. 16-3-20-697, where a company caused another company to be organized in a different state and the stockholders exchanged their stock share for share, the Committee on Appeals and Review in holding there was no taxable gain said:

> "This was in essence merely an incorporation in a different state without essential change in business capitalization or surplus."

But the Supreme Court in *Eisner* v. *Macomber*, at page 210, says, a change from surplus to capital equal to the proposed dividend is of no importance from the point of view of income taxibility, "is merely bookkeeping", "affects only the form not the essence". Such a change cannot of itself make taxable income; and the income tax office in making distinctions based on the theory that a change in capital or surplus can of itself make taxable income is flying in the face of the decision of the Supreme Court.

IV.

We have said that the practice and rulings of the Bureau are contradictory and confusing; and to show this we shall call some of them to the attention of the Court. But though they are contradictory and confusing they show clearly enough that for the first few years a reorganized corporation was considered by the Bureau as the same, in substance, as the original corporation,—so clearly indeed as to make the practice and rulings an administrative construction of the law. This continued until the Bureau refused to follow in all cases of a reorganization[1] the principles of the stock dividend decision.

1. Letter, May 3, 1915, Corporation Trust Company, I. T. S., 1918, Paragraph 1292, said:

[1] By reorganization we mean the case we have been talking about where shares are exchanged for shares in a new company organized to take over the assets of the old company.

Where a corporation having $500,000 capital stock and $500,000 surplus and good will beside was about to transfer its assets to its successor corporation for $5,000,000 par value of stock of the new corporation, no taxable gain would be made by the old corporation since in each corporation the assets were the same.

> "In the case cited the $5,000,000 capital stock issued in payment for the assets (tangible and intangible) of the first company is in fact of no greater actual value than is that of the $500,000 of the first company, for the reason that in each case the value of the stock is based upon and supported by the same assets, and until the stock issued by the purchasing or reorganized company in payment for the assets of the first company is converted into cash or its equivalent, no taxable income will have been realized from the transaction."

2. Letter, March 8, 1917, Corporation Trust Company, I. T. S., 1918, Paragraph 1302, said:

Where stockholders of a company exchanged their shares for shares of the same par value of a new company, organized to take over the assets of the old,—the new shares being actually worth double par,—no taxable gain resulted either to the old corporation or to the stockholders, saying that as the shares were exchanged share for share there was no stock dividend.

3. Letter, November 10, 1917, Corporation Trust Company, I. T. S., 1918, Paragraph 1309, said:

Where a corporation having a capital of $50,000 and a surplus of $3,750,000 proposed to transfer its assets to a new corporation in exchange for $4,000,000 of its stock and bonds and to distribute these securities to its stockholders and dissolve the corporation, it would realize taxable profits; and the stockholders would also realize taxable profits to the extent of the surplus of the old company distributed among them.

4. A. R. R. 16 (3-20-697), June, 1920; Cumulative Bulletin, p. 312. A corporation reincorporated in another state and stock of old corporation was exchanged for stock of new share for share of equal par value. The Committee said: "The change of domicile took place in 1916, and the Committee has considered a number of precedents established under the acts of 1913 and 1916, with regard to the treatment of essentially similar transactions * * * It also finds that in numerous cases it was held that no income accrued to the stockholders by reason of exchange of their stock in the old for stock in the new corporation."

5. In O. D. 783 (5-21-1414), in June, 1921, Cumulative Bulletin 45 there is a direct contra-

diction of the preceding sentence "Under these statutes (1913 and 1916) this office has consistently held that gain or loss arises from such transactions if the stock received in exchange has a market value even though the aggregate par value of the stock received in the exchange is not greater than the aggregate par value of the stock parted with."

This statement seems to be an entirely erroneous statement of what the Bureau actually had held.

6. A. R. R. 844 (1-14-206) Bulletin 14, April 3, 1922, page 27, the Committee held the same as A. R. R. 16 (3-20-697) cited under 5.

It will be seen that these opinions and letters are contradictory and confusing.

As we understand the facts from the publications of the income tax Bureau (we can speak only from what the Bureau has published), a correct statement by the Bureau would read as follows:

> "The office first uniformly took the position that stocks in different companies where they were exchanged whether share for share or one share for several shares are essentially *not* different properties. The office has of late continued to take the position that when they are exchanged share for share they are *not* essentialy different properties, and that a taxable profit is *not* real-

ized if the value of the stock received in exchange is in excess of the cost of the stock so exchanged; but it has also taken the position that when they are exchanged several shares for one they *are* essentially different properties, and that a taxable profit *is* realized if the value of the stock received in exchange is in excess of the cost of the stock so exchanged."

Such a practice cannot be sustained. The income tax office cannot in certain cases do one thing and in others governed by identically the same principle do the opposite. If an exchange is made of one share of stock for one share in a new corporation, either it is a completed transaction or it is not. If it is, then an exchange of one share for five shares is a completed transaction. If it is not, then the exchange of one share for five shares is not a completed transaction. Either the two corporations are different entities or they are not. Either taxable gain results from the exchange of stock in one company for another or it does not; but the income tax office cannot make identity into difference or make profits appear or vanish according as five shares or one share of precisely the same value represent precisely the same interest in precisely the same corporation.

The theory under which the Government says that a stockholder must pay the difference be-

tween the cost of one share of old stock and the market value of five shares which he receives in exchange is that a sale has taken place for the equivalent of money. If that is true it is equally true whether he receives five shares or one. If five shares in the new company are something different from one share in the old company, then one share in the new company is something different from one share in the old company.

To adopt the distinctions of the income tax office is to say that when A receives for one share of stock in a company which cost him thirty dollars, five shares of stock in a new company of a market value of six hundred dollars, he makes five hundred and seventy dollars profit; and that when B on the same day receives for one share of stock in a company which cost him thirty dollars *one* share of stock in a new company of a market value of six hundred dollars he makes no profit.

V.

A rule to decide whether any transaction is a change, not in substance but only in form, may be found, we suggest, in this:

To determine whether or not in any case taxable income has been received, find out whether what has been done could have been done in an-

other way, which admittedly would not have produced taxable income. In other words if there are two methods of producing one thing from another and the product in one case is not taxable it is not taxable in the other. The product is the substance and that is identical. The method is the form and that is different.

What we start with is a company having a certain amount of common stock; what we come out with is a company having five times that amount of common stock, each holder of one share of stock in the old company ending up with five shares of stock of the new company, and the new company having the assets of the old company.

Is there any way in which this result might have been obtained so that under the decisions of the Supreme Court and the rulings of the income tax office the stockholder does not receive taxable income? Yes, as follows:

(1) The old company could have declared a stock dividend of four hundred per cent.; each holder of one share would thereafter have been the holder of five shares of the old company. There would have been no taxable income. *Eisner* v. *Macomber.*

(2) The holders of the stock of the old company could then have exchanged their stock share for share for stock of the new company

without having received taxable income. A. R. R. 16 (3-20-697), June, 1920, Cumulative Bulletin, page 312. A. R. R. 844 (1-14-206), Bulletin 14, April 3, 1922, page 27.

Another method:

(1) The old corporation could have exchanged its stock, share for share, for the stock of the new corporation.

(2) The new corporation could then have declared a stock dividend. *Eisner* v. *Macomber.*

Conclusion.

In the case which we are presenting to the Court—where a new corporation has been organized to take over the assets and liabilities of an existing corporation and in exchange for their shares the stockholders of the old corporation have received shares of the new corporation of a total par value greater than that of their shares of the old corporation and of a market value greater than the cost of their old shares—the stockholders make no taxable gain and are not liable to income taxes until a sale of their shares.

Respectfully submitted,

JAMES BYRNE,
Amicus Curiæ.

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No. 301

IN THE

Supreme Court of the United States,

OCTOBER TERM, 1922.

J. S. CULLINAN,

Plaintiff in Error,

against

A. S. WALKER, AS COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF TEXAS,

Defendant in Error.

BRIEF SUBMITTED WITH THE CONSENT OF THE COURT.

ARTHUR A. BALLANTINE,
Amicus Curiæ.

The Evening Post Job Printing Office, Inc., 154 Fulton St., New York, N. Y.

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The decision and opinion in the case at Bar will determine whether under the Revenue Act of 1916 income arises from the exchange of stock in a corporation for stock in a new corporation incidentally to reincorporation or reorganization. Every stockholder of corporations which were reincorporated or reorganized in 1916 and 1917 is interested in this decision 1

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IN THE

Supreme Court of the United States,

OCTOBER TERM, 1922.

J. S. CULLINAN,
Plaintiff in Error,

AGAINST

A. S. WALKER, as Collector of Internal Revenue for the First District of Texas,
Defendant in Error.

Brief submitted with the Consent of the Court by

Arthur A. Ballantine,
Amicus Curiæ.

Statement.

The issues in this case also arise in a number of other cases which will at no distant date come before this Court for decision. Many cases now the subject of controversy between taxpayers and the Government in which the situation is in essential respects analogous to that in this case, will be largely determined by the decision and opinion in this case.

The case at bar requires a decision whether under the Revenue Act of 1916 (39 Stat. 756) income arises from the exchange of stock in a corporation for stock in a new corporation incidentally to reincorporation or reorganization. A

number of large corporations were reincorporated or reorganized in 1916 and 1917 (during which years the Revenue Act of 1916 was effective) and every stockholder of such corporations is interested in the decision of the questions at bar. As a basis for consideration of the underlying legal question here presented, a case similar to the case at bar, but simpler, may be assumed as follows: A corporation was organized under the laws of Delaware with capital stock having a par value of $100,000 and consisting of 1,000 shares. The Company had in 1916 an earned surplus of $100,000, and A (an individual stockholder) owned one-tenth of the stock which he purchased in 1914 at par. In 1916, the company was reorganized by the incorporation of a new corporation of the same name under the laws of Delaware, with a capital stock of $200,000, consisting of 2,000 shares. All of the assets were transferred to the new company and no change was made in the accounts except that the earned surplus was applied against additional capital stock. Each stockholder of the old company received two shares of new stock for each share of old stock. A surrendered his 100 shares of old stock, having a total par value of $10,000 and worth $20,000, and received in lieu thereof 200 shares of new stock having a total par value of $20,000 and worth that amount. The 100 shares of stock in the old company and the 200 shares in

the new alike represented a one-tenth interest in the company.

It is here submitted that A received no income from this reorganization exchange.

The Treasury Department's Change of Position.

The Department originally ruled that there was no income either to the old corporation or to its stockholders upon reorganization, without reference to the relative par value of the old and new stock. *Letter May 3, 1915,* Corporation Trust Company, I. T. S. 1918, Paragraph 1292; *letter April 1, 1915,* Corporation Trust Company, I. T. S. 1918, Paragraph 398.

This ruling has been adhered to by the Committee on Appeals and Review (the appellate committee of the Department) where there is merely a change in domicile of the corporation with no change in the aggregate par value of the capital stock or in the assets of the corporation (*A. R. R. 16.* Cum. Bul. June, 1920, p. 312; *A. R. R. 844,* Cum. Bul. I-1, June, 1922, p. 397. No ruling has been published under which stockholders have been taxed upon income resulting from a reorganization exchange in which it affirmatively appeared that there had not been an increase in the aggregate par value of the stock outstanding. There has, however, been a certain general statement by the Income Tax Unit (the administrative branch of the Depart-

ment) that the stock of the new company would be deemed property essentially different from the stock of the old company even though there was no increase in aggregate par value (*O. D. 783*, Cum. Bul. June, 1921, p. 45).

But where the new stock had a greater par value than the old stock, the Department later reversed its original position and held that a stockholder realized a gain or loss from the reorganization exchange. *Letter November 10, 1917*, Corporation Trust Company Income Tax Service, 1918, paragraph 1309; *Letter December 8, 1917*, Corporation Trust Company I. T. S. 1918, Paragraph 1313; *Letter March 19, 1918*, Corporation Trust Company I. T. S. 1918, Paragraph 3222; *A. R. R. 156*, Cum. Bul. June, 1920, page 39; *A. R. R. 289*, Cum. Bul. December, 1920, page 57.

This total reversal in the rule as to the effect of reorganizations where the stockholder received stock having a greater par value than his old stock was apparently due to the determination to tax all stock dividends or transactions of a substantially similar nature. There can be no other reason for making the status of the reorganization transaction depend upon the relative par values. The same distinction was incorporated in Section 202 of the Revenue Act of 1918, presumably as a result of the Departmental rulings.

These and other Departmental rulings are set forth in detail in Appendix A.

The Statute.

The provision of the Revenue Act of 1916 defining income reads in part as follows:

> "SECTION 2(*a*). That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include *gains, profits,* and *income* derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or *sales,* or *dealings in property,* whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever: * * * (*c*) For the purpose of ascertaining the gain derived from the *sale or other disposition of property,* real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived." (Italics ours.)

This act does not mention reorganizations, and so far as this question is concerned, specifically taxes only gains derived from sales or dealings

in property or from the sale or other disposition of property.

The Revenue Act of 1918, in Section 213, continued substantially this definition of income, taxed stock dividends, and in Section 202, contained the following provisions with reference to reorganizations and exchanges:

> "SECTION 202 (*b*). When property is exchanged for other property, the property received in exchange shall for the purpose of determining gain or loss be treated as the equivalent of cash to the amount of its fair market value, if any; but when in connection with the reorganization, merger, or consolidation of a corporation a person receives in place of stock or securities owned by him new stock or securities of no greater aggregate par or face value, no gain or loss shall be deemed to occur from the exchange, and the new stock or securities received shall be treated as taking the place of the stock, securities, or property exchanged.
>
> When in the case of any such reorganization, merger, or consolidation the aggregate par or face value of the new stock or securities received is in excess of the aggregate par or face value of the stock or securities exchanged, a like amount in par or face value of the new stock or securities received shall be treated as taking the place of the stock or securities exchanged, and the amount of the excess in par or face value shall be treated as a gain to the extent that the fair market value of the new stock or securities is greater

> than the cost (or if acquired prior to March 1, 1913, the fair market value as of that date) of the stock or securities exchanged."

This was the first act which specifically mentioned exchanges, and this section imposed a tax on reorganization exchanges only where there was an increase in par value so that the exchange had the effect of a stock dividend.

The Revenue Act of 1921 (enacted after the decision of this Court in *Eisner* v. *Macomber*, 252 U. S. 189, that stock dividends were not taxable) continued substantially the same definition of income in Section 213, made provision that stock dividends should not be treated as income, and in Section 202 made it perfectly clear that no tax should be imposed as the result of a reorganization by providing that no gain or loss should be recognized

> "When, in the reorganization of one or more corporations a person receives in place of any stock or securities owned by him, stock or securities in a corporation a party to or resulting from such reorganization." Section 202 (*c*) (2).

The Court Decisions.

This Court has defined "income" within the meaning of the Sixteenth Amendment as follows:

> "After examining dictionaries in common use * * * we find little to add to the succinct definition adopted in two cases aris-

ing under the Corporation Tax Act of 1909 (*Stratton's Independence* v. *Howbert,* 231 U. S. 399, 415; *Doyle* v. *Mitchell Bros. Co.,* 247 U. S. 179, 185)—'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets, to which it was applied in the *Doyle Case* (pp. 183, 185).

Brief as it is, it indicates the characteristic and distinguishing attribute of income essential for a correct solution of the present controversy. The Government, although basing its argument upon the definition as quoted, placed chief emphasis upon the word 'gain', which was extended to include a variety of meanings; while the significance of the next three words was either overlooked or misconceived. *'Derived—from—capital'; —'the gain—derived—from—capital',* etc. Here we have the essential matter: *not* a gain *accruing* to *capital,* not a *growth* or *increment* of value *in* the investment; but a gain, a profit, something of exchangeable value *proceeding from* the property, *severed from* the capital however invested or employed, and *coming in,* being *'derived',* that is, *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit and disposal;—*that* is income derived from property. Nothing else answers the description." (Italics by the Court.)

Eisner v. *Macomber,* 252 U. S. 189 (1920).

The Court in that case held that a stock dividend is not income since the stockholder receives nothing and the corporation parts with nothing. The Court pointed out that if the recipient of a stock dividend sold part of the stock received, he necessarily disposed of a part of his capital interest just as if he should sell a part of his old stock, and continued—

> "Yet, without selling, the shareholder, unless possessed of other resources, has not the wherewithal to pay an income tax upon the dividend stock. Nothing could more clearly show that to tax a stock dividend is to tax a capital increase, and not income, than this demonstration that in the nature of things it requires conversion of capital in order to pay the tax."

The Court has held that where, in contrast to the stock dividend and reorganization procedure, the corporation does part with some of its assets through real distributions to its stockholders, there is a "gain * * * from dividends", even though the assets distributed are in the form of stock of a new corporation organized to take over some part of the assets of the original corporation.

> *U. S.* v. *Phellis,* 257 U. S. 156 (1921); *Rockefeller* v. *U. S.,* 257 U. S. 176 (1921).

The proposition here advanced is that where a stockholder simply receives stock in a new corpo-

ration representing in all substantial respects the same interest in the same assets as were represented by his original stock, there is no gain, profit or income within the meaning of the statute as expounded by the Court. In such a case the stockholder no more derives a gain from a disposition of property than he derives a "gain from dividends" in the case of a stock dividend. The Court has settled the stock dividend issue; and what the Court declared in the case of stock dividends is equally applicable to these reorganization exchange cases:

> "The essential and controlling fact is that the stockholder has received nothing out of the company's assets for his separate use and benefit; on the contrary, every dollar of his original investment, together with whatever accretions and accumulations have resulted from employment of his money and that of the other stockholders in the business of the company, still remains the property of the company, and subject to business risks which may result in wiping out the entire investment. Having regard to the very truth of the matter, to substance and not to form, he has received nothing that answers the definition of income within the meaning of the Sixteenth Amendment" (*Eisner* v. *Macomber, supra*).

The recent decision of the Circuit Court of Appeals for the Sixth Circuit, in *Weiss* v. *Stearn*

(Corporation Trust Company, Federal Income Tax Service 1923, p. 709) was to the effect that no income was realized by the exchange of stock in a corporation for stock in a new corporation formed to take over the business as a going concern. In that case the stockholders received both cash and stock in the new company. It was admitted that income was realized by the receipt of the cash but it was denied that income was realized by the receipt of the stock in the new company and the court so held. In that case the par value of the new securities exceeded the par value of the old securities. The Court held that, in substance, the stockholders continued their investment in the business enterprise and that the technical change in the corporate entity was not sufficient basis for imposing a tax upon unrealized appreciation. The Court held that the reorganization exchange was, in substance, the same as a stock dividend.

I.

A stockholder turning in his stock in a reorganization and receiving other stock in its place, does not sell, dispose of or deal in his stock.

The 1916 statute does not mention reorganizations and so far as this question is concerned, taxes only gains arising from the sale or other disposition of property or from dealings in property.

That a stockholder in the case of a reorganization does not *sell* his stock is obvious. He receives no price from some other person for it and does not, in fact, part with his interest in the corporate assets. It is true that the Massachusetts Supreme Court, passing on a State statute taxing gains from "purchases or sales" has held that such a transaction was a "purchase or sale". *Osgood* v. *Tax Commissioners,* 235 Mass. 88 (1920). But this Massachusetts decision is not based upon any consideration of the substantial character of the transaction. It rests upon the academic ground that the stock in the new corporation is in a technical legal sense acquired by "purchase" and hence that the transaction is a "sale" within the statute. "Purchase", however, in this sense, refers to "every lawful mode of coming into an estate by act of a party as opposed to the act of the law" and not to anything which need involve a sale in the ordinary sense of the term in which the word is used in the Revenue Act of 1916. This decision was by a Court which, unlike the Supreme Court, had held stock dividends and the entire amount received from the sale of rights to subscribe for stock to constitute income (*Tax Commissioner* v. *Putnam, 227* Mass. 522, (1917). Its decision on the reorganization question is no more in harmony with the interpretation of the federal tax statutes than its decisions on the stock dividend question and on the sale of

rights question (*Eisner* v. *Macomber, supra; Miles* v. *Safe Deposit Co.*, 66 L. Ed. 570, U. S. Sup. Ct., 1922).

It is equally clear in such a case that the stockholder does not *"deal"* in the stock. To "deal" in the statutory sense means to part with the property and to get some different property back from some other person. A stockholder in a reorganization of this sort continues to hold his original interest although in a somewhat changed form. He is not dealing with anyone but simply with himself.

Nor does the stockholder in a reorganization *"dispose of"* his stock. To dispose of a thing means to get rid of it. Here the stockholder keeps the thing he started with. It is merely given a different dress.

The transaction here in question does not, therefore, come within any statutory language of the 1916 law.

II.

The stockholder in such a reorganization makes no "realization" of income: he merely receives back his own property in somewhat changed form.

To have taxable gain or income, there must be a definite realization of some sort marked by the receipt by the taxpayer of cash or other property from some other person. There must be something "coming in" that is "received or drawn by

the recipient for his separate use, benefit and disposal". When a taxpayer is paid for something in money, the gain, if any, is realized through the receipt of the money; similarly, when he is paid in new property having a market value. Thus, if shares of stock are exchanged with another person for merchandise having a fair market value, there is a realization which may give rise to gain or income. The same is true of a dividend paid in property, for in such cases, the stockholder receives from the corporation property not previously owned by him. But when nothing is received by the stockholder which he has not previously owned and held in the same legal relationship, there can be no realization of income.

It is settled that mere appreciation in the value of property without realization is not gain or income. Such appreciation may never be realized and taxation of it would require the sale of part of the property already owned in order to make payment. The decision on this point in *Baldwin Locomotive Works* v. *McCoach,* 221 Fed. 59 (1915), *T. D. 2185,* was acquiesced in by the Department (*Letter to Collectors Aug. 14, 1914,* Corporation Trust Co. I. T. S. 1917, par. 1247), is the position now taken in the Regulations (*Art. 23,* Regulations 62), and by the Court. (*Lynch* v. *Turrish,* 247 U. S. 221 (1918); *Eisner* v. *Macomber, supra*).

It is the complete lack of realization in the

case of a stock dividend that is the basis for the stock dividend decision. In that case, the Court held there was no income because the corporation parted with nothing and the stockholder received nothing which he had not previously owned. The absence of this transfer of property to the stockholder from the corporation made it clear that there could be no income to the stockholder, and the fact that in order to pay a tax upon such alleged income, the stockholder would have to sell a part of his capital interest, was regarded by the Court as clearly showing that to tax a stock dividend is to tax a capital increase and not income.

In the *Rockefeller* and *Phellis* cases the original corporations did part with assets which the stockholders received and which the stockholders could sell without reducing their proportional interest in the old corporation. Thus, in the *Phellis* case the Court said:

> "the individual stockholders of the old company, including claimant, received assets of exchangeable and actual value severed from their capital interest in the old company, proceeding from it as the result of a division of former corporate profits, and drawn by them severally for their individual and separate use and benefit. Such a gain resulting from their ownership of stock in the old company, and proceeding from it, constituted individual income in the proper sense" (*U. S.* v. *Phellis, supra*).

In the case of a reorganization exchange of new stock for old, as in the case of a stock dividend, there is no such severing of assets from the company and handing them over to the stockholders for their individual and separate use and benefit. The stockholder merely gets back new indicia of ownership for the property which he originally held. He does not get back other property or receive anything from other persons. In form he does receive stock from a new corporation, but this is merely a formal and not a substantial transaction. The "essential and controlling fact" is that the business enterprise in which he has invested has parted with nothing; it has exactly the same assets as before and has transferred nothing to him.

As in the stock dividend case, the stockholder, unless he has other resources, could pay no tax upon this gain without selling some part of the stock received and thereby reducing his proportional interest in the corporation. To impose a tax under these circumstances would be to treat mere unrealized appreciation as income. Paraphasing slightly the vital statement in the stock dividend decision quoted above, the Court might truly say

> "Yet, without selling, the shareholder, unless possessed of other resources, has not the wherewithal to pay an income tax upon the reorganization stock. Nothing could more

clearly show that to tax a reorganization exchange is to tax a capital increase, and not income, than this demonstration that in the nature of things it requires conversion of capital in order to pay the tax."

This reorganization exchange no more results in the realization of gain than the exchange between A and B of certificates of stock in a large corporation, such certificates calling for the same number of shares and being identical in every respect except the certificate number and the name of the stockholder. Certainly no one would consider such an exchange even though between separate and distinct persons as a realization of gain or loss for the reason that there was no exchange of property for other property. Where the taxpayer merely deals with himself, it is still clearer that there can be no gain or income.

No business man would regard the transaction under consideration as productive of gain. In such a case, his idea is simply that he is continuing his investment in the enterprise. If the Government should say to him that he had made a gain, he would inquire out of whom he had made it? If he has sold or disposed of his stock in the old company, who received it? If he has received some new property not previously owned by him, from whom has he received it? If he has realized income, from whom did it come in? In this case, the stockholder has been dealing solely

with himself and he certainly cannot realize income by dealing with himself or by receiving new indicia of ownership of old assets.

It is no answer to this argument to state that the stock in the new corporation is essentially different property from the stock in the old corporation. The Bureau of Internal Revenue correctly holds that a mere change of domicile with no change in the aggregate par value of the stock will not be considered the creation of a new corporation or produce income to the stockholders (*A. R. R. 16, supra*). And the stock dividend decision (*Eisner* v. *Macomber, supra*) shows that the mere increase in par value of the outstanding stock furnishes no basis for treating the new stock as property essentially different from the old stock. The Circuit Court of Appeals for the Sixth Circuit has specifically held that no income results from an exchange of stock for stock having a greater aggregate par value, in connection with a reorganization under the laws of the same State (*Weiss* v. *Stearn, supra*). Where the new stock in all substantial respects represents the same interest in the same assets as the old stock, it cannot be held that in any substantial respect it is different property. In all its decisions as to the meaning of income, the Supreme Court has declared that what governs is "the very truth of the matter"—not form but substance (*Eisner* v. *Macomber, supra; U. S.* v. *Phellis, supra*). In

the very recent decision as to income arising from the sale of rights to subscribe for stock, the Court said,—

> "To treat the stockholder's right to the new shares as something new and independent of the old, and as if it actually cost nothing, would ignore the essence of the matter, and the suggestion cannot be accepted" (*Miles* v. *Safe Deposit Co., supra*).

The essence of the reorganization exchange is that the stockholder gets no new property, but new indicia for the ownership of his old property. There is in truth no transaction between the stockholder and another person; no conversion of property into property "essentially different"—recognized in *Art. 1564* of Treasury Regulations 62 as essential to an income-producing exchange. There is no parting with property by the corporate enterprise for it continues to have the same assets and there is no receipt of property by the shareholder for he simply continues to have his same proportionate interest in the enterprise. *Art. 1564, supra,* merely recognizes the truth, equally valid in 1916 and 1917, that an exchange gives rise to no income unless it marks a realization of gain as distinguished from a continuation of ownership of the same property. Every element of such a realization is lacking here as in the case of stock dividend.

III.

Examination of the various Revenue Acts shows that Congress at no time expressed an intent to tax reorganization exchanges as such. Under the 1918 Act provision was made to exact tax upon such an exchange as in effect accomplished the distribution of a stock dividend, but the basis of this provision was eliminated by the stock dividend decision and the provision was accordingly omitted from the 1921 Act. Reorganization exchanges are to be treated as standing the same under the 1916 Act as under the 1921 Act.

The 1913 and 1916 Acts contained no provision as to reorganization exchanges. We have shown above that the language of the 1916 Act does not naturally include a transaction such as is here under consideration.

The 1918 Act expressly provided that reorganization exchanges should be taxed only where the stockholder received in exchange for his old stock a greater aggregate par value of new stock so that the reorganization was the substantial equivalent of a stock dividend. The statute at that time, of course, expressly provided for the taxation of stock dividends and the failure to tax reorganizations involving an increase in the par value of the stock would have made it easy to avoid the provision imposing a tax upon stock dividends. Reorganization exchanges, however, were taxed only to the extent that they furnished

possible equivalents for a stock dividend. All those reorganization exchanges where there was no increase in aggregate par value, no matter how fundamental the other changes in the corporate structure might be, were expressly exempted from taxation.

When the Revenue Act of 1921 was adopted, it was clear from the Court's decision in *Eisner* v. *Macomber* (*supra*) that stock dividends could not be taxed and that statute accordingly imposed no tax upon reorganization exchanges. This must be considered as an expression by Congress that such transactions did not give rise to income. The 1918 and 1921 acts expressly provide for the taxation of gain arising from ordinary exchanges of property. The express exclusion of reorganization exchanges was therefore advisable to prevent any attempt by the Department to impose a tax in such cases, but the action of Congress was not based on the idea that income resulted here which it was unwise to tax, but rather on the theory that no income resulted from such a nominal change in the indicia of ownership, and that the statute should make it clear that Congress had no intention of imposing a tax in such case.

A survey of the statutes shows, therefore, that at no time have reorganization exchanges been expressly taxed except where they were the sub-

stantial equivalent of a stock dividend, and the reason and basis for such a tax disappeared with the stock dividend decision. Under these circumstances, the Revenue Act of 1916 should be interpreted as imposing no tax upon the stockholders of a reorganized corporation for the reason that they are continuing to hold substantially the same property, and that any tax would rest upon mere increase in value and not upon income.

It appears, therefore, that the Treasury Department originally held that reorganization exchanges gave rise to no income, and that this view has been departed from only for the purpose of exacting a tax where the reorganization was the substantial equivalent of a stock dividend. Similarly, the various Revenue Acts have not in terms taxed stockholders participating in reorganization exchanges. On the contrary, the 1918 and 1921 Acts expressly exempted such transactions from tax except that the 1918 Act in support of an express tax on stock dividends taxed reorganization exchanges which were substantially equivalent to stock dividends. Any basis for these departures from the original position of the Department that reorganization exchanges gave rise to no income, was removed by the stock dividend decision. A reorganization exchange in fact gives rise to no realization of income since the stockholder receives no new property from some

other person but merely continues his investment in the same corporate enterprise, and the corporate enterprise parts with nothing. It follows that under the Revenue Act of 1916 no income arises from an exchange of stock incidental to a new corporation or reorganization.

Respectfully submitted,

ARTHUR A. BALLANTINE,
Amicus Curiæ.

APPENDIX A.

Memorandum Setting Forth Departmental Decisions Re Reorganization Exchanges.

A statement is made below of the published decisions of the Treasury Department dealing with the taxation of the stockholders of a corporation upon the transfer of securities incident to reorganizations occurring prior to 1918. Decisions dealing with the relation of the old to the new corporations are included, since in many cases these decisions show that only a formal, and not a substantial, change has taken place. The decisions are given in chronological order with a brief comment as to the bearing of each decision upon this general question.

(1) *Letter April 1, 1915, Corporation Trust Company I. T. S. 1918, Paragraph 398.*

This letter held that where an individual exchanged a share of stock in the A corporation having a par value of $100 for two shares of stock in the B corporation, each share having a par value of $100, this did not constitute a completed and closed transaction because it was an exchange of assets for assets of practically the same form.

It is not entirely clear that corporation B was a successor of corporation A in the above case, but the ruling clearly shows that in April, 1915,

the Bureau held that in the case of an exchange of stock incident to a reorganization, there would be no gain to the stockholder even though the new stock had a larger aggregate par value than the old. There is nothing in the 1916 statute which would require a different result than that reached under the 1913 act, since both were silent as to exchanges in general and as to reorganizations.

The earlier rulings of the Department, therefore, were to the effect that a stockholder received no gain by exchanging stock in one corporation for stock in a successor corporation.

(2) *Letter May 3, 1915, Corporation Trust Company I. T. S. 1918, Paragraph 1292.*

A corporation having $500,000 capital stock and $500,000 surplus, and a large developed good will, proposed to transfer its assets to a successor corporation for $5,000,000 par value of stock of the new corporation. This letter held that the old corporation did not receive any income by reason of this transfer since in each case the value of the stock was based upon and supported by the same assets.

This letter did not specifically pass upon the taxable result if the stockholders of the old corporation had transferred their stock for the stock of the new corporation, but necessarily implies that such a transfer would have been considered a continuing transaction giving rise to no income.

(3) *Letter March 8, 1917, Corporation Trust Company I. T. S. 1918, Paragraph 1302.*

In this case the Bureau held that a reorganization whereby the stockholders exchanged stock in the old corporation share for share for stock of the new company of the same par value but actually worth double par, gave rise to no taxable income either to the old corporation or to the stockholders.

This letter continues the Departmental attitude that reorganization exchanges give rise to no income, at least where there is no increase in the par value of the stock, and the letter specifically notes the fact that such a transfer "would not constitute a stock dividend". This letter says nothing specifically about reorganization exchanges where there is an increase in aggregate par value, but perhaps implies that in such cases the stockholder would be treated as having received a stock dividend.

(4) *Letter November 10, 1917, Corporation Trust Company I. T. S. 1918, Paragraph 1309.*

A corporation having a capital of $50,000 and a surplus of $3,750,000 proposed to transfer its assets to a successor corporation in exchange for $2,000,000 of bonds, $1,000,000 of preferred stock, and $1,000,000 of common stock. The old corporation would then distribute these securities *pro rata* to its stockholders and disolve. The

letter holds (*a*) that the corporation would realize a taxable profit as the result of transferring its assets for securities of the new corporation, and (*b*) that that part of the distribution to stockholders which represents surplus of the old corporation would be taxable as an ordinary dividend.

In this ruling the Department follows strictly the form of the transaction and treats the successor corporation as a separate and distinct entity. This is a definite departure from the earlier views of the Department with reference to reorganizations.

(5) *Regulations 33, Revised January 2, 1918.*

In paragraph 410 of these regulations it was held that where a new corporation issued its stock to the stockholders of an old corporation and thus became the sole stockholder of the old corporation, there was no income *to the old corporation* even though the new corporation then took over the assets for a nominal consideration. However, if the stock of the new corporation was transferred to the old corporation for its assets, the regulation held that the old corporation did receive income. There was no specific ruling as to the gain *to the stockholders* of the old corporation.

This regulation is significant in that it points out a way in which the reorganization of a cor-

poration could be accomplished without any gain resulting to the old corporation.

(6) *Letter March 19, 1918, Corporation Trust Company I. T. S. 1918, Paragraph 3222.*

In this letter it was held that where the old corporation transferred its assets for the stock of the new corporation and then distributed such stock to its stockholders and dissolved (*a*) the old corporation derived a gain from the transfer of its assets, and (*b*) the new stock distributed to the old stockholders was an ordinary dividend to the extent that it represented a distribution of earnings and a liquidating dividend as to the balance.

Here again the Department strictly follows the form of the transaction, treats the old and new corporations as separate and distinct entities, and the old and the new stock as different property.

It might be noted that no one of the above rulings squarely holds that a stockholder receives income where he transfers his old stock directly to the new corporation in exchange for its stock. Rulings (1) and (3) hold that the stockholder receives no income in a reorganization exchange. Rulings (2) and (5) deal solely with the gain to the corporation, and rulings (4) and (6) deal with cases where the new stock is distributed by the old corporation which has previously received it in exchange for its total assets.

(7) *A. R. R. 16 (3-20-697) June, 1920, Cumulative Bulletin, p. 312.*

In this case the Committee on Appeals and Review held that where a corporation reincorporated in a different state without essential change as to business, capitalization or surplus, the corporation would be considered to continue as the same taxable entity. The Committee said with reference to such reorganizations prior to 1918:

> "It finds that under such conditions it was the practice of the Bureau to require only one return as covering the income of both the old and the new corporation. It also finds that in numerous cases it was held that no income accrued to the stockholders by reason of exchange of their stock in the old for stock in the new corporation."

This is a distinct recognition of the validity of the earlier rulings of the Department to the effect that a reorganization was not an income producing transaction, at least where there was no change in the capitalization, business or assets of the company.

(8) *A. R. R. 156 (26-20-1024) June, 1920, Cumulative Bulletin, p. 39.*

In this case there was a reorganization in 1915 whereby the stockholders received in exchange for stock a larger number of shares of new stock, which presumably had a larger par value, though this is not specifically stated.

The Committee held that the provisions of Section 202 of the Revenue Act of 1918 did not apply to 1915 transactions, and that this was an exchange of property between the owner and another person for property which was essentially different and that it gave rise to income.

The Committee does not point out who the other party to the transaction was or in what respects the new property was essentially different from the old. The new stock did consist of preferred and common, while the old stock was all common, but each old stockholder had exactly the same assets after the reorganization as he had before. It is, therefore, difficult to see in what respects the new property was essentially different from the old, or with what other person the stockholder was dealing.

(9) *A. R. R. 289 (44-20-1274) December, 1920, Cummulative Bulletin, p. 57.*

In this case there was a reorganization in 1917 whereby the stockholders received in exchange for three shares of preferred and one share of common stock in the old company four shares of preferred and five shares of common stock in the new company. The Committee held that this exchange gave rise to taxable income, stating:

> "Upon the first question the office has uniformly taken the position that stocks in dif-

ferent companies are essentially different properties and that a taxable profit is realized if the value of the stock received in exchange is in excess of the cost of the stock so exchanged."

The rulings listed above show, however, that this has not, in fact, been the uniform practice of the Bureau. No other reason is given for the decision of the Bureau.

(10) *O. D. 783 (5-21-1414) June, 1921, Cumulative Bulletin, p. 45.*

This decision by the Income Tax Unit states broadly that the provisions of Section 202 of the Revenue Act of 1918 are not retroactive, and states:

> "It has been the uniform practice of the Department under the prior income tax statutes in dealing with all exchanges of stock in one corporation for stock in another corporation to recognize the different entities and to regard the stock received in exchange as essentially different property from that disposed of."

This decision does not explain in what respects the new stock is essentially different from the old stock, and as shown above this has not been the uniform practice of the Department.

(11) *A. R. R. 844* (*1-14-206*) Cum. Bul. I-1, June 1922, p. 397.

In this decision the Committee again held that the transfer of a corporation from one state to another state without any accompanying change in business, capitalization, surplus or stock ownership was not a sale to a new entity, but was a continuation of the old corporation. This referred to a reorganization which took place in 1914.

CULLINAN *v.* WALKER, AS COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF TEXAS.

ERROR TO THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF TEXAS.

No. 301. Argued March 9, 1923.—Decided April 30, 1923.

1. The gain accruing to a shareholder through enhancement of the value of his shares, and which, when segregated, becomes legally income subject to the income tax, may be segregated by a dividend made on liquidation of the corporation as well as by an ordinary dividend. P. 137.
2. Partly to comply with its state law and partly to procure additional credit for the business, an oil corporation was dissolved; its trustees in liquidation formed a producing corporation and a pipe line corporation, in the same State, transferred one-half of the assets to each, receiving from each in return its stock and its bonds, transferred all this stock to a holding corporation, which they formed in another State, receiving in exchange its stock, and distributed this stock, with the bonds of the other two existing corporations, among the persons who had been the stockholders of the dissolved concern. The three new corporations had at the time of the distribution no assets other than those so received from the trustees and the value of the assets was the same as when the trustees held them. *Held*, that the securities thus distributed were not in legal effect a stock dividend, and that a distributee was taxable under the income tax provision of September 8, 1916, c. 463, Tit. I, §§ 1 and 2, 39 Stat. 756, upon the amount by which the securities he received exceeded in value his investment in the shares of the original corporation. P. 136. *United States* v. *Phellis*, 257 U. S. 156.

Affirmed.

ERROR to a judgment of the District Court in an action against an internal revenue collector to recover back a tax, paid under protest.

Mr. John Walsh, with whom *Mr. William Wright Moore* and *Mr. Beeman Strong* were on the brief, for plaintiff in error.

Mr. Solicitor General Beck, with whom *Mr. Nelson T. Hartson* and *Mr. P. C. Alexander* were on the brief, for defendant in error.

Mr. James Byrne, by leave of court, filed a brief as *amicus curiae*.

Mr. Arthur A. Ballantine, by leave of court, filed a brief as *amicus curiae*.

MR. JUSTICE BRANDEIS delivered the opinion of the Court.

A tax of $156,212.66 was laid upon Cullinan, under the Act of September 8, 1916, c. 463, Title I, §§ 1 and 2, 39 Stat. 756, 757, for additional gain or income of that year, assessed at $1,571,760. He paid the tax, under protest; and brought, in the federal court for southern Texas, this action against the local collector of internal revenue to recover the amount. The question was whether certain securities received by Cullinan in that year should be deemed gain or income. The case was tried by the court without a jury, upon agreed facts; and judgment was entered for defendant. Cullinan contends that securities issued to him, which the collector treated as gain or income, were, in legal effect, like a stock dividend; and that, under *Eisner* v. *Macomber*, 252 U. S. 189, he was not taxable thereon. The Government insists that the securities so distributed were gains or income within the rule laid down in *United States* v. *Phellis*, 257 U. S. 156, and *Rockefeller* v. *United States*, 257 U. S. 176. This issue, presented on the facts hereinafter stated, is the only matter for decision. The case is here on writ of error under § 238 of the Judicial Code, because of the constitutional question involved. *Towne* v. *Eisner*, 245 U. S. 418.

Farmers Petroleum Company was, in 1915, a Texas corporation, with a capital stock of $100,000. Cullinan

owned 26.64 per cent. of its stock, for which he had paid (in that, and the preceding year) $26,640 in cash. Later in 1915, the company was dissolved under the Texas law; and Cullinan became one of the trustees in liquidation. In 1916 the trustees organized two Texas corporations: Republic Production Company, a producing concern, and American Petroleum Company, a pipe line concern. To these corporations the trustees transferred the assets held by them; one-half in value to each. From each they received $1,500,000 par value of its stock and $1,500,000 par value of its bonds; being the total issues. The trustees also organized under the laws of Delaware a third company: American Republics Corporation, a holding company. To this company the trustees transferred all the $1,500,000 stock of each of the new Texas corporations; from it they received $3,000,000 of its stock. They thus held in 1916 the $3,000,000 stock of the Delaware corporation and the $1,500,000 bonds of each of the new Texas corporations. All these securities the trustees then distributed *pro rata* among the persons who had been stockholders in Farmers Petroleum Company.

Farmers Petroleum Company had been dissolved solely for the purpose of effecting a reorganization. The reorganization was undertaken, partly, in order to separate the pipe lines from the producing properties, which counsel advised was necessary; and, partly, in order to procure credit required for the developing business. The two new Texas corporations had at the time of the distribution of the stock of the Delaware corporation no assets other than those received from the trustees in liquidation. These assets were at the time of distribution of the same value as they were when held by the trustees in liquidation. Cullinan received 26.64 per cent. of each class of security. The stock and bonds distributed were then all worth par. The aggregate value of the securities received by him was $1,598,400. The amount which he

had invested in Farmers Petroleum Company was $26,640. On the difference, $1,571,760, the internal revenue collector assessed the tax here in question.

Cullinan insists that his gain so ascertained was merely an incident of a reorganization. This was equally true in the *Phellis* and the *Rockefeller Cases*. It is sought to differentiate those cases on the ground, that there the distributed stock of the new corporation was technically a dividend paid out of surplus; and that here the segregation is not of that character. But the gain, which when segregated becomes legally income subject to the tax, may be segregated by a dividend in liquidation, as well as by the ordinary dividend. If the trustees in liquidation had sold all the assets for $6,000,000 in cash, and had distributed all of that, no one would question that the late stockholders of Farmers Petroleum Company would, in the aggregate, have received a gain of $5,900,000, taxable as income. The result would obviously have been the same, if the trustees had taken in payment, and distributed, bonds of the value of $6,000,000, in some new corporations. And the result must, also, be the same where that taken in payment is $3,000,000 of such bonds and $3,000,000 in stock of a third corporation. All the material elements which differentiate the *Phellis* and *Rockefeller Cases* from *Eisner* v. *Macomber* are present also here. The corporation, whose stock the trustees distributed, was a holding company. In this respect, it differed from Farmers Petroleum Company, which was a producing and pipe line company. It differed from the latter, also, because it was organized under the laws of another State. It is true that, at the time this Delaware corporation's stock was distributed, it held the stock of the new oil producing company and likewise the stock of the new pipe line company. But the Delaware corporation was a holding company. It was free, at any time, to sell the whole, or any

part, of the stock in either of the new Texas companies and to invest the proceeds otherwise. By such a sale, and change of investments, all interest of the holding company in the original enterprise might be parted with, without, in any way, affecting the rights of its own stockholders. When the trustees in liquidation distributed the securities in the three new corporations, Cullinan, in a legal sense, realized his gain; and became taxable on it as income for the year 1916.

Affirmed.

YUMA COUNTY WATER USERS' ASSOCIATION